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Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, 1929

No. 314

NILES BEMENT POND COMPANY, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED AUGUST 9, 1929

CERTIORARI GRANTED OCTOBER 21, 1929

(34,445)

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ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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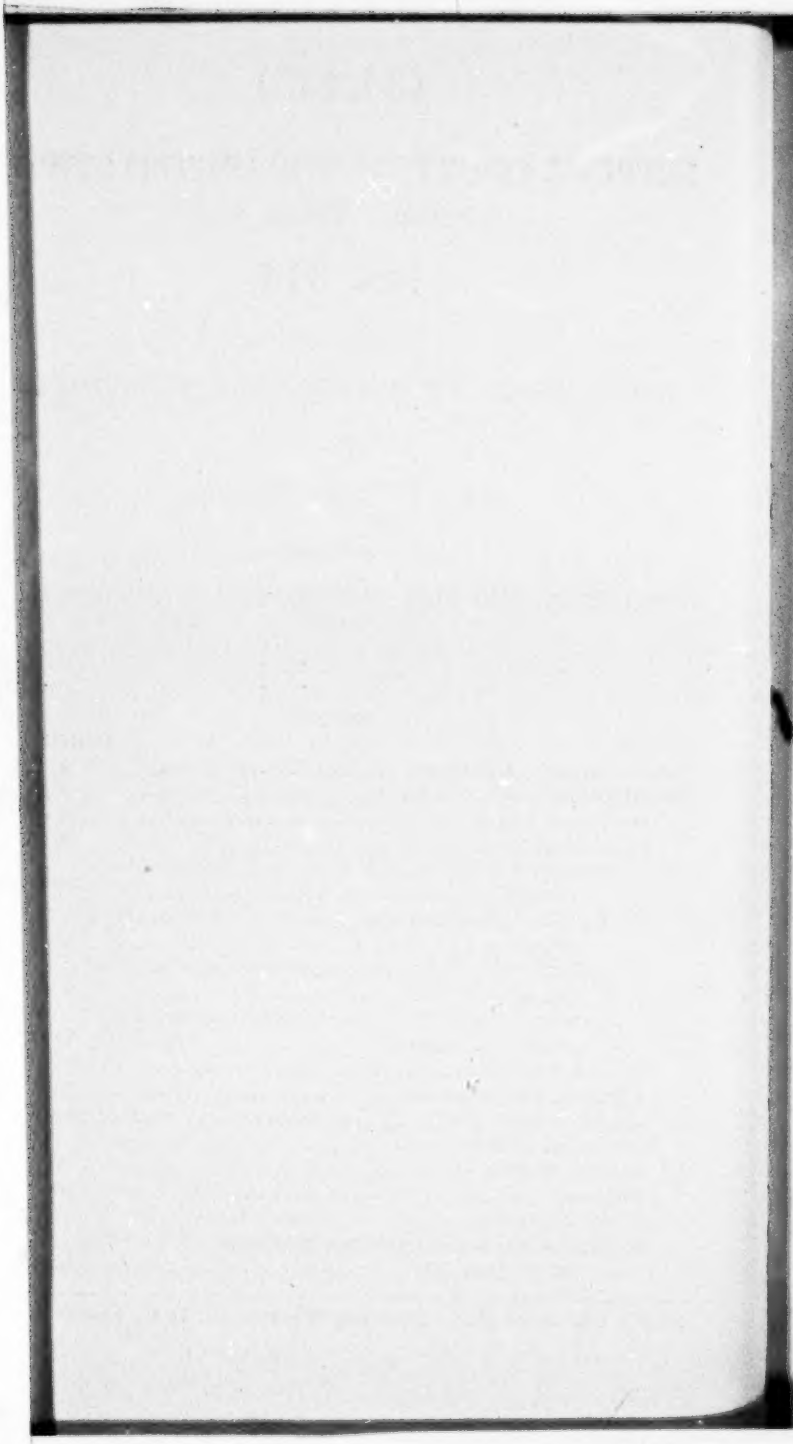


[fol. 1]

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 314

NILES BEMENT POND COMPANY, Petitioner,

vs.

THE UNITED STATES, Respondent

PETITION FOR WRIT OF CERTIORARI

MAY IT PLEASE THE COURT:

The petition of Niles Bement Pond Company respectfully shows to this Honorable Court:

A

Summary Statement of the Matter Involved

This suit was instituted in the Court of Claims to recover corporate income and profits taxes for 1917 and 1918 alleged to have been erroneously and illegally collected by respondent from petitioner. The question here presented is:

Whether petitioner was entitled in 1918 to a credit under Section 238 (a) of the Revenue Act of 1918 (Chap. 18, 40 Stat. L. 1057, 1080) for certain British income taxes and excess profits duties paid during 1918, where the first in-

[fol. 2] formation received by petitioner as to the amount of such taxes so payable was received in 1918 and the taxes were first entered upon petitioner's books during 1918 as an expense for that year in accordance with the method of accounting regularly employed by petitioner in keeping its books.

The findings of fact upon this question, (Nos. V to XI, inclusive) show:

During the year 1918 petitioner paid to the Government of Great Britain an income tax for the year ending April 5, 1918 and also an excess profits duty for the ac-

counting period ended December 31, 1916. These taxes were paid pursuant to notices, one dated January 24, 1918, and the other dated January 19, 1918, which notices were the first notice, assessment, demand or information received by petitioner as to the amount of the taxes so payable. Under the method of accounting regularly employed by petitioner in keeping its books throughout the year 1918, the accounting for expenses of its London Office was on a cash disbursements basis and no accruals were made for any such expenses in advance of their payment. The British taxes paid in 1918 were expenses of petitioner's London Office and were entered on the petitioner's books of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping petitioner's books. Except for expenses of the London Office and some additional small items where the cash basis was reflected, petitioner's books were kept on the accrual basis and the principal and dominant purpose and plan of its accounts were to show income upon an accrual basis as the general and controlling character of the accounts.

[fol. 3] It is not disputed that these taxes and duties were of the character allowable as a credit under Section 238 (a) of the Revenue Act of 1918. The question is whether such credit may be taken in the year 1918. The Commissioner of Internal Revenue disallowed the credit in 1918, thereby increasing the tax payable for that year. The tax was paid by petitioner and suit was filed by it in the Court of Claims for recovery. The Court of Claims held that credit was not properly taken in 1918 and dismissed the petition.

The question is whether credit may be taken (and the statutory provisions are the same as to the deduction of expenses) in the year of payment, when the method of accounting regularly employed calls for entry in the books of account on a cash disbursements basis, the majority of the taxpayer's accounts being upon an accrual basis but a considerable section of such accounts, as in this case all the London Office expense accounts of this petitioner, being on a cash basis.

The pertinent statutory provisions are in the Revenue Act of 1918, (Chap. 18, 40 Stat. L. 1057) and are as follows:

Section 238 (a). (40 Stat. L. 1080.) "That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by title III (Excess profits tax) shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein * * *."

Section 200. (40 Stat. L. 1058.) "The term 'paid' for the purposes of the deductions and credits under this title, means 'paid or accrued' or 'paid or incurred,' and the terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under Section 212."

[fol. 4] Section 212 (b). (40) Stat. L. 1064.) "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *"

B

Reasons Relied on for the Allowance of the Writ

1. The Court of Claims has decided an important question of Federal law which has not been but should be settled by this Court. That question is the meaning of the phrase "method of accounting regularly employed in keeping the books of such taxpayer" appearing in Section 212 (b) of the Revenue Act of 1918. This same phrase appears in the Revenue Acts of 1921, 1924, 1926, and 1928 and its correct construction and application is of the utmost importance to many taxpayers. This Court has decided the meaning of a similar phrase in the 1916 Act (Sec. 13 d of

Chap. 463, 39 Stat. L. 770) where the books were upon an accrual basis and the entries in question were made as accruals or should have been so made under the method of accounting regularly employed (*United States* vs. *Anderson* and *United States* vs. *Yale & Towne Company*, 269 U. S. 422, reversing *Anderson* vs. *United States*, 60 Ct. Cls. 106 and *Yale & Towne Company* vs. *United States*, 60 Ct. Cls. 440; *American National Company* vs. *United States*, 274 U. S. 99). This Court has also decided the meaning of the phrase in the 1918 Act, where the accounts were upon a cash basis (*United States* vs. *Mitchell*, 271 U. S. 9, reversing *Mitchell* vs. *United States*, 60 Ct. Cls. 451). This Court [fol. 5] has never considered or decided the meaning of the phrase where the majority of the taxpayer's accounts are upon an accrual basis but where a considerable portion of such accounts, due to some peculiar condition, such as the operation of the London Office of this petitioner, are upon a cash basis and the expenditure in question pertains to the latter group of accounts. The existing confusion and uncertainty as to the application of the statute to such mixed accounting systems will continue until the question is definitely settled by a decision of this Court.

2. The Court of Claims erred in holding that the statutory phrase 'method of accounting regularly employed in keeping the books of such taxpayer," describes only two systems of accounts, one a "strict cash basis" and the other a "strict accrual basis." The Court held, in effect, that books must be kept and income returned upon one or the other of these two bases. The governing statutes make no reference to or provision regarding either a "cash basis" or an "accrual basis" of accounts.

3. The Court of Claims erred in holding that petitioner was not entitled to a credit in 1918 for British taxes under Section 238 (a) of the Revenue Act of 1918, although it found as facts that such taxes were paid in 1918, and were entered on petitioner's book of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping such books.

4. The Court of Claims erred in considering as material the fact that accounts other than the London Office accounts to which the British taxes belonged, were kept on the "ac-

crual basis," and in holding that under a method of ac-
[fol. 6] counting upon a mixed accrual and cash disbursements basis a credit was allowable according to the basis of the majority of the accounts regardless of the basis of the particular account in which the expenditure belonged.

5. The Court of Claims erred in denying to petitioner its claim for credit for British taxes paid in 1918.

6. The Court of Claims erred in dismissing the petition and in entering judgment for the defendant.

Wherefore, your petitioner respectively prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Court of Claims commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. E-177, Niles Bement Pond Company vs. United States, and that the said judgment of the Court of Claims may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Niles Bement Pond Company, by Karl D. Loos, E. Barrett Prettyman, Preston B. Kavanagh, Counsel for Petitioner.

Washington, D. C., August 9, 1929.

[fol. 7] [Endorsed:] Supreme Court of the United States, October term, 1929. No. —. Niles Bement Pond Company, petitioner, vs. The United States, respondent. Petition for writ of certiorari. Karl D. Loos, E. Barrett Prettyman, Preston B. Kavanagh, Counsel for Petitioner.

[fol. 1] COURT OF CLAIMS OF THE UNITED STATES

No. E-177

NILES BEMENT POND COMPANY

v.

THE UNITED STATES

I. HISTORY OF PROCEEDINGS

On March 14, 1925, the plaintiff filed its original petition.

On May 13, 1925, the defendant filed a general traverse to said petition.

On March 26, 1927, by leave of court, the plaintiff filed its amended petition. Said amended petition is as follows:

II. AMENDED PETITION—Filed March 26, 1927

To the Honorable the Court of Claims:

The claimant, Niles Bement Pond Company, respectfully shows this Honorable Court:

1. Claimant is, and has been continuously for a period antedating all matters hereinafter stated, a corporation duly organized and existing under the laws of the State of New Jersey with its principal place of business at New York City. Claimant is now and was at all times hereinafter mentioned engaged in the business of manufacturing and selling machine tools in different states and territories of the United States and elsewhere.

[fol. 2] 2. Pursuant to the provisions of an Act of Congress entitled "An Act to Increase the Revenue, and for other Purposes," approved September 8, 1916, (39 Stat. L. 756), hereinafter referred to as the "Revenue Act of 1916" and of an Act of Congress entitled "An Act to Provide Revenue to defray war expenses, and for other Purposes," approved October 3, 1917 (40 Stat. L. 300), hereinafter referred to as the "Revenue Act of 1917," and particularly pursuant to Part II of Title I of said

Revenue Act of 1916 and Section 4 of Title I of said Revenue Act of 1917, claimant filed its corporation income tax return setting forth a statement and report of its net income for the calendar year 1917 and setting forth also other matters as required by said Revenue Acts of 1916 and 1917 and by Rules and Regulations promulgated thereunder by the Commissioner of Internal Revenue who is hereinafter referred to as the Commissioner. Pursuant to said Revenue Act of 1917 and particularly Title II thereof, claimant also filed its corporation excess profits tax return setting forth a statement and report of the net income and invested capital for the calendar year 1917 of claimant and of subsidiary companies, to-wit: Niles Bement Pond Company of Massachusetts and Pratt & Whitney Company of Delaware, which subsidiary companies were consolidated with claimant in said corporation excess profits tax return. Claimant owned the entire capital stock of said subsidiary companies and in accordance with the provisions of the Revenue Act of 1917 and Regulations issued thereunder by the Commissioner the income and invested capital of said subsidiaries was included and consolidated with the income and invested capital of claimant. The income and invested capital of said subsidiaries [fol. 3] is referred to herein only for the purpose of computing the taxes of claimant and by the term "consolidated invested capital," as hereinafter used, is meant the invested capital of claimant and its subsidiaries required by said Revenue Act of 1917 and the Regulations of the Commissioner thereunder to be consolidated with claimant, and by the term "consolidated income" is meant the total income of claimant and its subsidiaries required by the Revenue Act of 1917 and by regulations of the Commissioner thereunder to be consolidated with claimant. The taxes, if any, paid by the said subsidiaries are not relevant to this proceeding and the income and invested capital of said subsidiaries is relevant solely for the purpose of computing the taxes of claimant. Said returns were the subject of investigation and audit by said Commissioner and as a result thereof the tax liability of claimant for the calendar year 1917 on account of income and excess profits taxes was fixed by said Commissioner at the sum of $271,505.16, which said amount claimant has here-

tofore paid in full to the United States on to wit: June 7, 1918.

3. In the determination of the 1917 tax liability as aforesaid, the Commissioner made certain erroneous, improper, unlawful and wrongful rulings with reference to adjustments of the net income and invested capital for 1917 which rulings resulted in an unlawful, excessive, improper and erroneous determination of the tax liability of claimant for the calendar year 1917 and caused claimant to pay as income and excess profits tax an amount in excess of its true tax liability determined in accordance with the provisions of said Revenue Act of 1917, to-wit:

(a) The Commissioner refused to allow as a deduction [fol. 4] from income the sum of $15,000.00 paid by claimant during the calendar year 1917 to the Red Cross, and deducted by claimant on its corporation income tax return for 1917, in reporting the net income subject to tax under said Revenue Acts of 1916 and 1917. Payment of said sum was made by claimant in the regular course of its business. At the time of said payment the United States was engaged in a war with the German Empire and other foreign enemies and the Red Cross to which said payment was made was engaged in activities in aid of the prosecution of said war. Without making such expenditure the Company could not have continued to conduct its business. Under the circumstances and conditions then existing the expenditure of said sum was an ordinary and necessary expense of claimant and was therefore deductible in accordance with the provisions of Section 12a, paragraph 1, of said Revenue Act of 1916 in determining the net income of claimant subject to taxes under said Revenue Acts of 1916 and 1917.

(b) The Commissioner deducted from 1917 income the sum of $4,488.72 representing an income tax paid by claimant to the Government of Great Britain. Said sum was paid by claimant in the year 1918 and did not accrue as a liability of claimant until after the beginning of the calendar year 1918. Being neither a payment in 1917 nor an accrual in 1917, this tax payment to the Government of Great Britain as aforesaid was not a proper deduction in

determining the net income of claimant for the year 1917 subject to tax under the provisions of said Revenue Acts of 1916 and 1917.

(c) The Commissioner reduced the consolidated invested capital for 1917 by the amount of $35,875.37 alleged to be [fol. 5] a liability accruing in 1916 for taxes to the Government of Great Britain. Said sum was paid to the British Government during the calendar year 1918 but not before. No liability for the payment of said sum existed or had accrued prior to the beginning of the calendar year 1918. The deduction of this amount from the consolidated invested capital for 1917 was therefore erroneous.

(d) The Commissioner also reduced the consolidated invested capital for 1917 by an erroneous adjustment of the amount at which certain Pratt & Whitney Company stock owned by claimant was included in the consolidated invested capital. Claimant owned on December 31, 1916, and throughout the year 1917, and still owns 15,250 shares of common stock of Pratt & Whitney Company, a corporation organized under the laws of the State of New Jersey. Said stock was acquired by claimant in the year 1901 as compensation for services rendered, to-wit: certain underwriting and promotion services performed by claimant in the reorganization and rehabilitation of said Pratt & Whitney Company. In addition to the rendition of the services as aforesaid claimant also paid the sum of $154,420.94 in cash to the holders of the common stock of the Pratt & Whitney Company of Connecticut, the predecessor of the Pratt & Whitney Company of New Jersey, whose stock claimant acquired. In its corporation excess profits tax return for 1917 claimant reported said Pratt & Whitney stock at an amount of $1,525,000.00. The Commissioner in his computations has included said Pratt & Whitney stock at an amount of $154,420.94, this being the amount of cash paid by claimant to the stockholders of the predecessor as aforesaid, the Commissioner ignoring the compensation to [fol. 6] claimant for the underwriting and promotion services performed by it as aforesaid. The true and correct value of said 15,250 shares of common stock of said Pratt & Whitney Company of New Jersey, on the date acquired

by claimant, to-wit: January, 1901, was not less than the sum of $1,525,000.00. The said amount should therefore be included in the computation of the consolidated invested capital for 1917 in accordance with Section 207 of said Revenue Act of 1917. Said Pratt & Whitney stock was an asset, the income from which was not subject to the tax imposed by Title II of said Revenue Act of 1917. As such it was an inadmissible asset, but should be included in invested capital to the extent that it, combined with all other inadmissible assets, did not exceed the total indebtedness of claimant and its subsidiaries. The total of all inadmissible assets owned by claimant and its subsidiaries other than said Pratt & Whitney stock was $4,427,185.00. The total indebtedness of claimant and its subsidiaries was $5,143,526.37.

4. As a result of his erroneous rulings as aforesaid, the Commissioner fixed claimant's net income for 1917 at $1,797,062.40 and the consolidated invested capital for 1917 at $12,129,883.44. The Commissioner computed the tax due from claimant as follows:

Consolidated Net Income

Net income of claimant	$1,797,062.40
Net income of Niles Bement Pond Co. of Mass.	46,393.09
	$1,843,455.49
Less net loss Pratt & Whitney Co. of Delaware	4,871.07
Aggregate net income	$1,838,584.42
Deduct dividends received	19,680.00
Consolidated net income for excess profits tax purposes	$1,818,904.42

[fol. 7] **Consolidated Invested Capital**

Consolidated invested capital	$12,129,883.44

Computation of Excess Profits Tax

Consolidated invested capital		$12,129,883.44
Consolidated net income		1,818,904.42
	Income	Tax
Deduction 7% $849,091.84 + 3,000	$851,091.84	
Taxable at 20%	967,812.58	$193,562.52
	$1,818,904.42	$193,562.52

Allocation of Excess Profits Tax

Claimant	$174,966.61
Niles Bement Pond Co. of Mass. (arbitrary)	18,595.91
Total	$193,562.52

Computation of Total Tax

	Income	Tax
Net income of claimant	$1,797,062.40	
Deduct excess profits tax	174,966.61	
Taxable at 2%	$1,622,095.79	$32,441.92
Less dividends from 1916 and 1917 earnings	19,680.00	
Taxable at 4%	$1,602,415.79	64,096.63
Excess profits tax		174,966.61
Total tax assessed against claimant		$271,505.16

5. Claimant's net income determined in accordance with the provisions of the Revenue Act of 1917 was $1,786,-551.12. This differs from the income fixed by the Commissioner as aforesaid, as follows:

Net income fixed by Commissioner		$1,797,062.40
Deduct payment to Red Cross, not deducted by Commissioner		15,000.00
		$1,782,062.40
Add British taxes not paid or accrued until 1918 and erroneously deducted by Commissioner in 1917		4,488.72
Correct net income for 1917		$1,786,551.12

The consolidated invested capital for claimant and subsidiaries determined in accordance with the provisions of [fol. 8] the Revenue Act of 1917 was $12,727,679.24. This differs from the invested capital fixed by the Commissioner as aforesaid, as follows:

Consolidated invested capital fixed by Commissioner		$12,129,883.44
Add: British taxes paid and accrued in 1918 treated by Commissioner as a liability in 1916		35,875.37
Pratt & Whitney Stock:		
Correct amount	$1,525,000.00	
Amount allowed by Commissioner	154,420.94	
Amount disallowed by Commissioner	$1,370,579.06	
Less excess of inadmissibles over indebtedness:		
Total in admissibles (including Pratt & Whitney stock)	$5,952,185.00	
Total indebtedness	5,143,526.37	
Excess	808,658.63	
Amount to be added to invested capital on account of Pratt & Whitney stock		561,920.43
Correct invested capital 1917		$12,727,679.24

The correct computation of the tax payable by claimant under the Revenue Act of 1917 is as follows:

Consolidated Net Income

Net income of claimant	$1,786,551.12
Net income of Niles Bement Pond Co. of Mass.	46,393.09
	$1,832,944.21
Less net loss Pratt & Whitney Co. of Delaware	4,871.07
Aggregate net income	$1,828,073.14
Deduct dividends received	19,680.00
Consolidated net income for excess profits tax purposes	$1,808,393.14

Consolidated Invested Capital

Consolidated invested capital	$12,727,679.24

Computation of Excess Profits Tax

Consolidated invested capital		$12,727,679.24
Consolidated net income		1,808,393.14
	Income	Tax
Deduction 7% $890,937.55 + $3,000	$893,937.55	
Taxable at 20%	914,455.59	$182,891.20
	$1,808,393.14	$182,891.20

[fol. 9] **Allocation of Excess Profits Tax**

Claimant	$164,295.29
Niles Bement Pond Company of Massachusetts	18,595.91
Total	$182,891.20

Computation of Total Tax

	Income	Tax
Net income of claimant	$1,786,551.12	
Deduct excess profits tax	164,295.29	
Taxable at 2%	$1,622,255.83	$32,445.12
Less dividends from 1916 and 1917 earnings	19,680.00	
Taxable at 4%	$1,602,575.83	64,103.03
Excess profits tax	.....	164,295.29
Total tax due from claimant		$260,843.44

The total tax due from claimant under the Revenue Act of 1917 was not more than $260,843.44. To the extent that the tax paid and collected, to-wit: the amount of $271,505.16 exceeded the amount of $260,843.44, as aforesaid, the tax paid and collected was excessive, unlawful, improper,

without authority and illegally and erroneously collected, said excess being the amount of to-wit: $10,661.72.

6. On or about February 29, 1924, claimant filed a claim for refund of taxes illegally collected for the calendar year 1917, said claim being in the amount of $11,644.22 or such greater amount as is legally refundable. Copy of said claim for refund is attached hereto as Exhibit "A" and by this reference made a part hereof and incorporated herein. On or about January 27, 1921, within less than five years after the return for 1917 was due, claimant filed with the Commissioner of Internal Revenue at Washington, D. C., a waiver of right to have the taxes due for such taxable year determined and assessed within five years after the return was filed. As a result of the filing of said waiver, [fol. 10] the time for filing claim for refund was extended to six years after the return for the year 1917 was due, all as provided in Section 252 of the Revenue Act of 1921 as amended by Act of March 4, 1923. (Ch. 276, 42 Stat. L. 1504.) Said claim for refund was filed within less than six years after the return for 1917 was due.

7. Thereafter on or about September 22, 1924, the Commissioner rejected and denied the aforesaid claim for refund of taxes illegally collected for the year 1917, giving notice of such action by letter addressed to claimant and bearing date of September 22, 1924. Copy of said letter is attached hereto as Exhibit "D" and by this reference is made a part hereof and incorporated herein.

8. Pursuant to the provisions of an Act of Congress entitled "An Act to Provide Revenue, and for other Purposes," approved February 24, 1919 (40 Stat. L. 1057), said act being hereinafter referred to as the Revenue Act of 1918, and particularly pursuant to Part III of Title II and Title III of said Revenue Act of 1918, claimant filed its corporation income and profits tax return for the calendar year 1918, said return being a consolidated return of claimant and the Niles Bement Pond Company of Massachusetts, the latter a subsidiary owned by claimant, setting forth a statement and report of the consolidated net income and consolidated invested capital for the calendar year 1918 and setting forth also other matters as required by said Revenue Act of 1918 and by rules and regulations promul-

gated thereunder by the Commissioner. The invested capital and income of said subsidiary is relevant to this proceeding only for the purpose of computing the taxes of claimant. Said return was the subject of investigation and [fol. 11] audit by said Commissioner and as a result thereof the tax liability of claimant for the calendar year 1918 on account of income and war profits and excess profits taxes was fixed by said Commissioner at the sum of $1,719,644.93 which said amount claimant has heretofore paid in full to the United States, payment of the last installment having been made on to-wit: December 14, 1919.

9. In the determination of the 1918 tax liability as aforesaid, the Commissioner made certain erroneous, improper, unlawful, wrongful rulings with reference to adjustments of the net income and invested capital for 1918 which rulings resulted in an unlawful, excessive, improper and erroneous determination of the tax liability of claimant for the calendar year 1918 and caused claimant to pay as income and excess profits tax an amount in excess of its true tax liability determined in accordance with the provisions of said Revenue Act of 1918, to-wit:

(a) The Commissioner refused to allow as a deduction from income the sum of $61,018.00 paid by claimant during the calendar year 1918 to the American Red Cross, and other organizations engaged in activities in aid of the prosecution of the war. Payment of said sums was made by claimant in part by its New York office direct and in part through its branch offices. All of said payments were made by claimant in the regular course of its business. At the time of said payments the United States was engaged in a war with the German Empire and other foreign enemies and the Red Cross and other organizations to which said payments were made were engaged in activities in aid of the prosecution of said war. Without making such expenditures the Company could not have continued to conduct [fol. 12] its business. Under the circumstances and conditions then existing the expenditure of said sums was an ordinary and necessary expense of claimant and was therefore deductible in accordance with the provisions of Section 234 (a) (1) of said Revenue Act of 1918.

(b) The Commissioner reduced the invested capital of claimant for 1918 by the amount of $40,364.09 alleged to be a liability accruing in 1917 for taxes to the Government of Great Britain. Said sum was paid to the British Government during the calendar year 1918 but not before. No liability for the payment of said sum existed or had accrued prior to the beginning of the calendar year 1918. The deduction of this amount from invested capital for 1918 was therefore erroneous.

(c) The Commissioner also reduced the consolidated invested capital by an erroneous adjustment of the amount at which certain Pratt & Whitney Company stock owned by claimant was included in the consolidated invested capital. Claimant owned on December 31, 1917, and throughout the year 1918, and still owns 15,250 shares of common stock of Pratt & Whitney Company, a corporation organized under the laws of the State of New Jersey. Said stock was acquired by claimant in the year 1901, as compensation for services rendered, to-wit: certain underwriting and promotion services performed by claimant in the reorganization and rehabilitation of said Pratt & Whitney Company. In addition to the rendition of the services as aforesaid claimant also paid the sum of $154,420.94 in cash to the holders of the common stock of the Pratt & Whitney Company of Connecticut, the predecessor of the Pratt & Whit-
[fol. 13] ney Company of New Jersey, whose stock claimant acquired. In its corporation profits tax return for 1918 claimant reported said Pratt & Whitney stock at an amount of $1,525,000.00. The Commissioner in his computations has included said Pratt & Whitney stock at an amount of $154,420.94, this being the amount of cash paid by claimant to the stockholders of the predecessor company as aforesaid, the Commissioner ignoring the compensation to claimant for the underwriting and promotion services performed by it as aforesaid. The true and correct value of said 15,250 shares of common stock of said Pratt & Whitney Company of New Jersey, on the date acquired by claimant, to-wit: January, 1901 was not less than the sum of $1,525,000. Said amount should therefore be included in full in the computation of the consolidated invested capital for 1918 (before adjustment on account of inadmissible assets).

Said Pratt & Whitney stock was an inadmissible asset as defined in Section 325 of said Revenue Act of 1918 and must be included with other inadmissible assets in making adjustment of invested capital on account of inadmissible assets, as provided in Section 326 (c) of said Revenue Act of 1918. The total of inadmissible assets averaged during the year, exclusive of said Pratt & Whitney stock, was $4,070,633.03. The total of admissible and inadmissible assets averaged during the year, exclusive of said Pratt & Whitney stock, was $19,825,696.38. Including said Pratt & Whitney stock at the correct amount, the above totals were $5,595,633.03 and $21,350,696.38, respectively.

(d) In 1918 claimant paid to the British Government the sum of $44,126.40 representing excess profits tax and the sum of $4,488.72 representing income tax. These amounts [fol. 14] were actually paid in the calendar year 1918 and were credited by the claimant on its tax return against the total tax for 1918 in accordance with Section 238 (a) of said Revenue Act of 1918. Subsequent to the filing of said return claimant received a refund of part of said excess profits tax reducing the net amount thereof to $31,588.87. Said British taxes were not liabilities prior to the beginning the calendar year 1918. Each of said taxes was paid and accrued in the calendar year 1918, in accordance with the definitions and provisions contained in sections 200 and 212 (b) of said Revenue Act of 1918. Each of said British taxes should be credited against the total tax otherwise payable as provided in Section 238 (a) of said Revenue Act of 1918 and the total credit claimed is $36,077.59.

10. As a result of his erroneous rulings as aforesaid, the Commissioner fixed the consolidated net income for 1918 at $2,949,008.37 and the consolidated invested capital at $10,036,319.34. The Commissioner computed the tax due from claimant as follows:

Computation of Excess Profits and War Profits Credits

Consolidated net income 1918	$2,949,008.37
Consolidated invested capital 1918	10,036,319.34
Excess Profits Credit:	
8% of invested capital for 1918	$802,905.55
Exemption	3,000.00
Excess profits credit	$805,905.55

War Profits Credit:

10% of invested capital for 1918	$1,003,631.93
Exemption	3,000.00
War profits credit	$1,006,631.93

[fol. 15] Computation of Total Tax

		Income	Tax
Excess Profits Tax:			
Net income for 1918		$2,949,008.37	
Less excess profits credit		805,905.55	
Balance		$2,143,102.82	
Taxable at 30%		$1,201,358.32	$360,407.50
Taxable at 65%		941,744.50	612,133.93
		$2,143,102.82	$972,541.43
War Profits Tax:			
Net income for 1918		$2,949,008.37	
Less war profits credit		1,006,631.93	
Taxable at 80%		$1,942,376.44	$1,553,901.15
Less excess profits tax		.....	972,541.43
War profits tax		.....	581,359.72
Total excess profits and war profits tax		.....	$1,553,901.15
Income Tax:			
Net income for 1918		$2,949,008.37	
Less:			
Interest on obligations of United States not exempt	$11,909.06		
War profits and excess profits tax	1,553,901.15		
Exemption	2,000.00		
		1,567,810.21	
Taxable at 12%		$1,381,198.16	165,743.78
Total war profits, excess profits and income taxes			$1,719,644.93

11. Claimant's net income determined in accordance with the Revenue Act of 1918 was $2,887,990.37 T his differs from the income fixed by the Commissioner as follows:

Net income fixed by Commissioner	$2,949,008.37
Deduct payments to Red Cross and other organizations	61,018.00
Correct net income for 1918	$2,887,990.37

The consolidated invested capital for claimant and subsidiary determined in accordance with the provisions of the Revenue Act of 1918 was $10,431,052.17. This differs from

[fol. 16] the invested capital fixed by the Commissioner as follows:

Consolidated invested capital fixed by Commissioner		$10,036,319.34
Add: British taxes paid and accrued in 1918 treated by Commissioner as a liability in 1916 and 1917		40,364.09
Pratt & Whitney Stock:		
Correct amount	$1,525,000.00	
Amount allowed by Commissioner	154,420.94	
Amount disallowed by Commissioner	$1,370,579.06	
Less additional adjustment for inadmissibles	1,016,210.32	
Amount to be added to invested capital on account of Pratt & Whitney stock		354,368.74
Correct invested capital 1918		$10,431,052.17

The corrected computation of the tax payable by claimant for the calendar year 1918 under the Revenue Act of 1918 is as follows:

Computation of Excess Profits and War Profits Credits

Consolidated net income 1918	$2,887,990.37
Consolidated invested capital 1918	10,431,052.17
Excess Profits Credit:	
8% of invested capital for 1918	$834,484.17
Exemption	3,000.00
Excess Profits Credit	$837,484.17
War Profits Credit:	
10% of invested capital for 1918	$1,043,105.22
Exemption	3,000.00
	$1,046,105.22

Computation of Total Tax

	Income	Tax
Excess Profits Tax:		
Net income for 1918	$2,887,990.37	
Less excess profits credit	837,484.17	
Balance	$2,050,506.20	
Taxable at 30%	1,248,726.26	374,617.88
Taxable at 65%	801,779.94	521,156.96
	$2,050,506.20	$895,774.84
[fol. 17] War Profits Tax:		
Net income for 1918	$2,887,990.37	
Less war profits credit	1,046,105.22	
Taxable at 80%	$1,841,885.15	$1,473,508.12
Less excess profits tax		895,774.84
War profits tax		577,733.28
Total excess profits and war profits tax		$1,473,508.12

Income tax:

Net income for year 1918		$2,887,990.37	
Less interest on obligations of U. S. not exempt	$11,909.06		
War profits and excess profits tax as above	1,473,508.12		
Exeption	2,000.00		
		1,487,417.18	
Taxable at 12%		$1,400,573.19	$168,068.78
Total war profits, excess profits and income taxes			$1,641,576.90
Less income and excess profits taxes paid British government on income arising from sources therein:			
Income tax		$4,488.72	
Excess profits tax (net)		31,588.87	
Total credit			36,077.59
Total war profits, excess profits and income taxes payable for 1918			$1,605,499.31

The total tax due from claimant for the calendar year 1918 under the Revenue Act of 1918 was not more than $1,605,499.31. To the extent that the tax paid and collected, to-wit: the amount of $1,719,644.93 exceeded the amount of $1,605,499.31 as aforesaid, the tax paid and collected was excessive, unlawful, improper, without authority, and illegally and erroneously collected, said excess being the amount of to-wit: $114,145.62.

12. On or about March 14, 1924, claimant filed a claim for refund of taxes illegally collected for the calendar year 1918, said claim being in the amount of $127,264.02 or such greater amount as is legally refundable. Said claim for refund was filed within less than five years after the claimant's return for 1918 was due. Copy of said claim is at-
[fol. 18] tached hereto as Exhibit "B" and by this reference is made a part hereof and incorporated herein.

13. Thereafter on or about September 22, 1924, the Commissioner rejected and denied the aforesaid claim for refund of taxes illegally collected for the year 1918, giving notice of such action by letter addressed to claimant and bearing date of September 22, 1924. Copy of said letter is attached hereto as Exhibit "D" and by this reference is made a part hereof and incorporated herein.

14. Pursuant to the provisions of said Revenue Act of 1918 and particularly pursuant to Part III of Title II and

Title III of said Revenue Act of 1918, claimant filed its corporation income and profits tax return for the calendar year 1919, said return being a consolidated return of claimant and the Niles Bement Pond Company of Massachusetts, the latter a subsidiary owned by claimant, setting forth a statement and report of the consolidated net income and consolidated invested capital for the calendar year 1919 and setting forth also other matters as required by said Revenue Act of 1918 and by rules and regulations promulgated thereunder by the Commissioner. The invested capital and income of said subsidiary is relevant to this proceeding only for the purpose of computing the taxes of claimant. Said return was the subject of investigation and audit by said Commissioner and as a result thereof the tax liability of claimant for the calendar year 1919 on account of income and excess profits taxes was fixed by said Commissioner at the sum of $323,177.92 which said amount claimant has heretofore paid in full to the United States, payment of the last installment having been made on to-wit: December 15, 1920.

[fol. 19] 15. In the determination of the 1919 tax liability as aforesaid, the Commissioner made certain erroneous, improper, unlawful and wrongful rulings with reference to adjustments of the net income and invested capital for 1919 which rulings resulted in an unlawful, excessive, improper and erroneous determination of the tax liability of claimant for the calendar year 1919 and caused claimant to pay as income and excess profits tax an amount in excess of its true tax liability determined in accordance with the provisions of said Revenue Act of 1918, to-wit:

(a) The Commissioner reduced the consolidated invested capital by an erroneous adjustment of the amount at which certain Pratt & Whitney Company stock owned by claimant was included in the consolidated invested capital. Claimant owned on December 31, 1918, and throughout the year 1919, and still owns 15,250 shares of common stock of Pratt & Whitney Company, a corporation organized under the laws of the State of New Jersey. Said stock was acquired by claimant, in the year 1901, as compensation for services rendered, to-wit: certain underwriting and promotion services performed by claimant in the re-

organization and rehabilitation of said Pratt & Whitney Company. In addition to the rendition of the services as aforesaid claimant also paid the sum of $154,420.94 in cash to the holders of the common stock of the Pratt & Whitney Company of Connecticut, the predecesor of the Pratt & Whitney Company of New Jersey, whose stock claimant acquired. In its corporation excess profits tax return for 1919 claimant reported said Pratt & Whitney stock at an amount of $1,525,000.00. The Commissioner in his computations has included said Pratt & Whitney stock at an [fol. 20] amount of $15,420.94, this being the amount of cash paid by claimant to the stockholders of the predecessor Company as aforesaid, the Commissioner ignoring the compensation to claimant for the underwriting and promotion services performed by it as aforesaid. The true and correct value of said 15,250 shares of common stock of said Pratt & Whitney Company of New Jersey, on the date acquired by claimant, to-wit: January, 1901, was not less than the sum of $1,525,000.00. Said amount should therefore be included in full in the computation of claimant's invested capital (before adjustment on account of inadmissible assets). Said Pratt & Whitney stock was an inadmissible asset as defined in Section 325 of said Revenue Act of 1918 and must be included with other inadmissible assets in making adjustment of invested capital on account of inadmisible assets as provided in Section 326 (c) of said Revenue Act of 1918. The total of inadmissible assets averaged during the year, exclusive of said Pratt & Whitney stock, was $4,169,932.53. The total admissible and inadmissible assets averaged during the year, exclusive of said Pratt & Whitney stock, was $20,368,419.97. Including said Pratt & Whitney stock at the correct amount, the above totals were $5,694,932.53 and $21,893,419.97, respectively.

16. As a result of his erroneous rulings as aforesaid, the Commissioner fixed the consolidated invested capital for 1919 at $10,794,242.12. The Commissioner computed the tax due from claimant as follows:

[fol. 21] Computation of Tax (1919) at 1918 Rates

Excess Profits Tax:	Income	Tax
Net income for taxable year	$1,567,001.71	
Less excess profits credit	866,539.37	
Balance	$700,462.34	
Taxable at 30%	$700,462.34	$210,138.70
War Profits Tax:		
Net income for taxable year	$1,567,001.71	
Less war profits tax	1,082,424.21	
Taxable at 80%	$484,577.50	387,662.00
Less excess profits tax		210,138.70
War profits tax		177,523.30
Total excess profits and war profits tax (computed at 1918 rates)		$387,662.00

Computation of Tax (1919) at 1919 Rates

Excess Profits Tax:	Income	Tax
Net income for taxable year	$1,567,001.71	
Less excess profits credit	866,539.37	
Balance	$700,462.34	
Taxable at 20%	$700,462.34	$140,092.47
Total excess profits tax (Computed at 1919 rates)		$140,092.47

Summary of Excess Profits and War Profits Taxes

Total profits taxes at 1918 rates	$387,662.00
Total profits tax at 1919 rates	140,092.47
(1) Income from Government contracts	382,814.21
(2) Income from other sources	1,184,187.50
(3) Total taxable income for year 1919	$1,567,001.71
(4) Proportion of (1) to (3)	.2443
(5) Proportion of (2) to (3)	.7557
(6) Percentage of (4) applied to profits taxes at 1918 rates	$94,705.83
(7) Percentage of (5) applied to profits tax at 1919 rates	105,867.88
Total excess profits and war profits tax for 1919	$200,573.71

[fol. 22] Computation of Total Tax (1919)

Total excess profits and war profits tax		$200,573.71
Income Tax:		
Net income for taxable year	$1,567,001.71	
Less:		
Interest on obligations of United States not exempt	$35,166.70	
Excess profits tax	200,573.71	
Exemption	2,000.00	
	237,740.41	
Taxable at 10%	$1,329,261.30	132,926.13
Total excess profits and income taxes		$333,499.84
Total tax		$323,177.92

17. Claimant's invested capital for 1919 determined in accordance with the Revenue Act of 1918 was $11,132,-543.53. This differs from the invested capital fixed by the Commissioner as follows:

Consolidated invested capital fixed by Commissioner		$10,794,242.12
Add:		
Pratt & Whitney stock—correct amount	$1,525,000.00	
Amount allowed by Commissioner	154,420.94	
Amount disallowed by Commissioner	$1,370,579.06	
Less additional adjustment for inadmissibles	1,032,277.65	
Amount to be added to invested capital on account of Pratt & Whitney stock		338,301.41
Correct invested capital 1919		$11,132,543.53

The correct computation of the tax payable by claimant for the calendar year 1919 under the Revenue Act of 1918, without allowance for changes in the taxes for prior years, is as follows:

[fol. 23] Computation of Tax (1919) at 1918 Rates

Excess Profits Tax:	Income	Tax
Net income for taxable year	$1,567,001.71	
Less excess profits credit	893,603.48	
Balance	$673,398.23	
Taxable at 30%	673,398.23	$202,019.47
	$673,398.23	$202,019.47

War Profits Tax:

Net income for taxable year	$1,567,001.71	
Less war profits credit	1,116,254.35	
Taxable at 80%	$450,747.36	$360,597.89
Less excess profits tax		202,019.47
War profits tax		158,578.42
Total excess profits and war profits tax (computed at 1918 rates)		$360,597.89

Computation of Tax (1919) at 1919 Rates

Excess Profits Tax:	Income	Tax
Net income for taxable year	$1,567,001.71	
Less excess profits credit	893,603.48	
Balance	$673,398.23	
Taxable at 20%	673,398.23	$134,679.65
Total excess profits tax (computed at 1919 rates)		$134,679.65

Summary of Excess Profits and War Profits Taxes

Total profits tax at 1918 rates as above		$360,597.89
Total profits tax at 1919 rates as above		134,679.65
(1) Income from Government contracts		382,814.21
(2) Income from other sources		1,184,187.50
(3) Total taxable income for year 1919		$1,567,001.71
(4) Proportion of (1) to (3)		.2443
(5) Proportion of (2) to (3)		.7557
(6) Percentage of (4) applied to profits taxes at 1918 rates.		$88,094.06
(7) Percentage of (5) applied to profits taxes at 1919 rates.		101,777.41
Total excess profits and war profits tax for 1919		189,871.47

[fol. 24]

Computation of Total Tax (1919)

Total excess profits and war profits tax			$189,871.47
Income Tax:			
Net income for taxable year		$1,567,001.71	
Less:			
Interest on obligations of United States not exempt	$35,166.70		
Excess profits tax	189,871.47		
Exemption	2,000.00		
		227,038.17	
Taxable at 10%		$1,339,963.54	133,996.35
Total excess profits and income taxes			$323,867.82
Less foreign income war profits and excess profits taxes			10,321.92
Total tax			$313,545.90

The total tax due from claimant for the calendar year 1919 under the Revenue Act of 1918 was not more than $313,545.90. To the extent that the tax paid and collected, to-wit: the amount of $323,177.92 exceeded the amount of $313,545.90 as aforesaid, the tax paid and collected was excessive, unlawful, improper, without authority, and illegally and erroneously collected, said excess being the amount of, to-wit: $9,632.02.

18. On or about May 16, 1924, claimant filed a claim for refund of taxes illegally collected for the calendar year 1919, said claim being in the amount of $9,632.02 or such greater amount as is legally refundable. Said claim for refund was filed within less than five years after the claimant's return for 1919 was due. Copy of said claim is attached hereto as Exhibit "C" and by this reference is made a part hereof and incorporated herein.

19. Thereafter on or about September 22, 1924, the Commissioner rejected and denied the aforesaid claim for refund of taxes illegally collected for the year 1919, giving notice of such action by letter addressed to claimant and bearing date of September 22, 1924. Copy of said letter [fol. 25] is attached hereto as Exhibit "D" and by this reference is made a part hereof and incorporated herein.

20. Claimant's claim as aforesaid first accrued on or about November 16, 1922, when the Commissioner by letter addressed to claimant under date of November 16, 1922, first made the rulings with respect to income, invested capital and foreign tax credits for the several years 1917, 1918 and 1919 which rulings were erroneous and unlawful as aforesaid and on account of which erroneous and unlawful rulings the claim herein is made. Thereafter claims for refund were presented to the Commissioner as aforesaid and said claims for refund were denied and rejected on or about September 22, 1924, less than two years prior to the date of this petition.

21. The actions of the Commissioner hereinbefore described constitute the action by the Treasury Department on the claims herein set out and no other action has been had thereon in Congress or by any other Department.

22. Claimant is and always has been the sole owner of the claims herein set out and has not assigned or transferred the whole or any part thereof or interest therein.

23. Claimant is justly entitled to recover from the United States, on account of the several claims herein set out, the sum of $134,439.36, after allowing all just credits and offsets, together with interest thereon at six percent per annum as follows: on $10,661.72 from June 7, 1918, on $114,145.62 from December 14, 1919, and on $9,632.02 from December 15, 1920, until the date of payment.

24. The claimant and all its officers and stockholders have at all times borne true allegiance to the Government [fol. 26-78] of the United States and have not in any way voluntarily aided, abetted, or given encouragement to rebellion against the said Government.

25. Claimant believes the facts as stated herein to be true.

Wherefore, the premises considered, claimant prays judgment against the United States in the full sum of $134,439.36 with interest thereon, as aforesaid.

Niles Bement Pond Company, by Edw. L. Leeds, Vice-President. Karl D. Loos, Attorney for the Claimant, 717 Munsey Bldg., Washington, D. C. E. Barrett Prettyman, of Counsel.

Duly sworn to by Edw. L. Leeds. Jurat omitted in printing.

[fol. 79] III. General Traverse—Filed May 5, 1927

And now comes the Attorney General, on behalf of the United States, and answering the amended petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the amended petition be dismissed.

Herman J. Galloway, Assistant Attorney General.
R. C. W.

IV. Argument and Submission

On October 11, 1928, this case was argued and submitted on merits by Mr. Karl D. Loos, for plaintiff, and by Mr. Ralph C. Williamson, for defendant.

[fol. 80] **Special Findings of Fact, Conclusion of Law, and Opinion of the Court by Graham, J.**—Filed May 13, 1929

This case having been heard by the Court of Claims upon the evidence, the court makes the following

SPECIAL FINDINGS OF FACT

I

The plaintiff, Niles Bement Pond Company, is and at all times since 1900 has been, a New Jersey corporation, with its principal place of business at New York City, and was throughout said period engaged in the business of manufacturing machine tools and selling such products in the various States of the United States, and in Great Britain and other parts of the world.

II

Plaintiff seasonably filed in proper form, Federal tax returns for the calendar years 1917, 1918, and 1919. Subsequent to the filing of the respective returns, the income and profits tax liability of plaintiff was determined and assessed for the year 1917 at $271,505.16; for the year 1918 at $1,719,644.93 and for the year 1919 at $323,177.92.

III

The total net payments of Federal income and profits taxes were made by plaintiff in the amounts and on the dates as follows:

1917. Paid June 6, 1918		$271,505.16	
1918. Niles Bement Pond Co. of Massachusetts:			
Paid Mar. 30, 1919		13,750.00	
June 17, 1919		13,750.00	
Sept. 11, 1919		13,750.00	
Dec. 17, 1919		13,750.00	
			$55,000.00
Niles Bement Pond Co.:			
Paid Mar. 30, 1919		662,500.00	
June 17, 1919		662,500.00	
Oct. 31, 1919		129,608.61	
Dec. 18, 1919		210,036.32	
			1,664,644.93
Total amount of tax shown to be due and paid.			1,719,644.93
[fol. 81]			
1919. Paid Mar. 31, 1920		$125,000.00	
June 26, 1920		125,000.00	
Sept. 15, 1920		55,557.49	
Dec. 15, 1920		17,620.43	
Total amount of tax shown to be due and paid.			$323,177.92

IV

Claims for refund for the years 1917, 1918, and 1919 were seasonably filed and were rejected on or about September 22, 1924.

V

Plaintiff during the year 1918 paid to the Government of Great Britain the sum of $4,488.72 representing income taxes for the year beginning April 6, 1917, and ending April 5, 1918, paid on income derived from sources within Great Britain, and no part of said amount was ever refunded to plaintiff. During the year 1918 plaintiff also paid to the Government of Great Britain the sum of $44,126.40 representing excess-profits duty for the accounting period ended December 31, 1916, paid on income derived from sources within Great Britain.

VI

Said amounts of $44,126.40 and $4,488.72, totalling $48,615.12 were claimed as a credit on the plaintiff's income and profits tax return for the calendar year 1918, said credit being claimed under section 238 of the revenue act of 1918. The tax paid by plaintiff for the year 1918 was computed and determined without the allowance of said amount, or any part thereof as a credit.

VII

Subsequent to the filing of the return for 1918, plaintiff received from the Government of Great Britain a net refund of $12,537.53, reducing the payment of British excess-profits tax to a net amount of $31,588.87.

VIII

The British income tax aforesaid was paid to the British Government pursuant to a notice dated January 24, 1918. The British excess-profits duty aforesaid was paid pursuant to a "Notice of assessment and notice to pay duty," dated January 19, 1918. Said notices were the first notice, assessment, demand, or information received by plaintiff as to the amount of the income tax and excess-profits duty,

respectively, so payable. The returns annually made by plaintiff to the British Government relating to income taxes and excess-profits duty contained no computation of the taxes; they contained only a report of income. Plaintiff in making its return of income did not attach any statement showing computation of the amount of the excess-profits duty payable by it for the accounting period ended December 31, 1916, or of the income tax for the year ending April 5, 1918.

[fol. 82] IX

Under the method of accounting regularly employed by plaintiff in keeping its books throughout the year 1918, the accounting for expenses of the London office was on a cash disbursements basis and no accruals were made for any such expenses in advance of their payment.

X

The British taxes paid in 1918 were expenses of plaintiff's London office and were entered on the plaintiff's books of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping plaintiff's books.

XI

British income tax in the amount of $10,321.92 for the year beginning April 6, 1918, and ending April 5, 1919, paid by plaintiff in 1919 was claimed as a credit on plaintiff's 1919 return and was allowed as such credit under section 238(a) of the revenue act of 1918. British income tax in the amount of $1,696.20 for the year beginning April 6, 1919, and ending April 5, 1920, was paid by plaintiff in 1924. No claim for credit was filed by plaintiff for 1920, nor was any such credit allowed; and no claim for credit was made in 1924, the plaintiff's return for that year showing a net loss and no tax due.

During the years 1916, 1917, 1918, and 1919, the books of the plaintiff were kept on the accrual basis. There were some exceptions in small items of deferred charges and credits in the plaintiff's accounts where the cash basis was reflected, but notwithstanding this the principal and dominant purpose and plan of its accounts were to show in-

come upon an accrual basis as the general and controlling character of the accounts.

Plaintiff's corporation income-tax return for the year 1916, its corporation income-tax return and its excess profits tax return for the year 1917, and its corporation income and profits tax returns for the years 1918 and 1919 were filed on the accrual basis.

The British income taxes paid by plaintiff in the year 1918 were assessed on account of income received in the years 1914, 1915, and 1916. The Commissioner of Internal Revenue allowed plaintiff deductions prior to 1918 for all of the British taxes in dispute. These taxes were based upon tax returns made by plaintiff prior to 1918.

XII

During all three of the calendar years 1917, 1918, and 1919 plaintiff owned 15,250 shares of the common stock of Pratt & Whitney Company, a corporation organized under the laws of the State of New Jersey.

XIII

Said stock was acquired by plaintiff in the year 1901 in the following manner:

In the year 1900, or shortly prior thereto, the then directors of the Pratt & Whitney Company determined that a reorganization and refinancing of that company was neces- [fol. 83] sary. After extensive negotiations arrangements were completed whereby the plaintiff undertook to formulate and execute such a plan of reorganization and refinancing. Among the conditions involved in this plan as finally agreed upon between the two companies was that the plaintiff should take over and assume the management of the Pratt & Whitney Company; that plaintiff should guarantee the dividends on the preferred stock of said Pratt & Whitney Company, and that the plaintiff should receive 15,250 shares of the common stock of the Pratt & Whitney Company, which were to be transferred to it by the former common stockholders of the Pratt & Whitney Company upon the payment to them of $10.00 cash per share. The total cash paid under this plan was $154,420.94. This plan was carried out during the year 1901 and the plaintiff thus acquired the said 15,250 shares of Pratt & Whitney common stock.

XIV

The following contract was executed under the date of July 9, 1900, and was thereafter performed substantially in accordance with its terms.

Parties

"Memorandum of Agreement entered into this ninth day of July, 1900, by and between the firm or co-partnership of Cuyler, Morgan and Company, of New York City, hereinafter called the first party, and Niles-Bement-Pond Company, hereinafter called the second party.

Purpose

Whereas the first party has been requested to reorganize in New Jersey the Pratt & Whitney Company, a Connecticut corporation, in such manner that its present preferred stockholders shall receive from the corporation as reorganized, preferred stock equal, in par value to 70% of the par value of their present holdings of preferred stock—that is, 12,250 shares of the preferred stock of the reorganized corporation, of the par value of $1,225,000, which shall constitute its entire issue of preferred stock, together with common stock of the reorganized corporation equal, in par value, to 30% of the par value of their present holdings of preferred stock—that is, 5,250 shares of the common stock of the reorganized corporation—of the par value of $525,000; and in such manner, further, that the present common stockholders of the Pratt & Whitney Co. shall receive from the corporation, as reorganized, common stock equal, in par value, to the par value of their present holdings of common stock; that is, 10,000 shares of the common stock of the reorganized corporation, of the par value of $1,000,000; and whereas the second party is desirous of acquiring and holding, when issued, the entire common stock of the reorganized corporation, that is, 15,250 shares of the par value of $1,525,000; all of which, will hereinafter more fully appear;

Consideration

Now, therefore, this agreement witnesseth, that the parties hereto, for and in consideration of the sum of one dol-

lar by each to the other in hand paid, the receipt whereof [fol. 84] is hereby acknowledged, as well as in consideration of the mutual covenants and promises herein contained, do covenant and agree as follows:

Organization of Proposed Corporation

First. The first party does covenant and agree to use its best endeavors and efforts to organize within thirty days after the date hereof, under the laws of New Jersey, a corporation, to be named "Pratt & Whitney Company," of perpetual existence, with a total authorized capital stock of $2,750,000 par value, divided into 12,250 shares of preferred and 15,250 shares of common stock of the par value of $100 each; which preferred stock shall be preferential both as to assets and dividends, which dividends shall be cumulative and payable quarterly at the rate of 6% per annum, and which preferred stock may be redeemed at par, plus accrued dividends, if any, by vote of a majority of the directors of said Pratt & Whitney Company, upon the first Monday of January, 1911, upon six months' notice by the said corporation to the holders thereof; and to procure all said stock, preferred and common, to be issued fully paid and nonassessable; that said Pratt & Whitney Company, if incorporated, to be organized in such manner that its real and personal property or either shall not be mortgaged except upon the consent in writing first obtained of the holders of 90% of its preferred stock issued and outstanding.

Property Thereof

Second. The first party does further covenant and agree to use its best efforts and endeavors to procure the said proposed Pratt & Whitney Company, immediately upon its organization as aforesaid, to take over and acquire, from the Pratt & Whitney Company, a Connecticut corporation, as of January 1, 1900, the entire plant and business, and all real and personal assets of the latter as a going concern, and to assume its liabilities as of that date, all such assets and liabilities to be as shown in the balance sheet of said the Pratt & Whitney Company of the date mentioned, a copy whereof is hereunto annexed and made a part of this agreement; the said plant and business, assets and lia-

bilities, to remain, between said January 1, 1900, and the date of actual transfer to the proposed Pratt & Whitney Company, and at the latter date to be, the same as shown in the said balance sheet, subject only, during such interval, to the fluctuations incident to the ordinary conduct by the present the Pratt & Whitney Company of the business of manufacturing and selling the regular products of its factory; and the said plant, business, and assets, as of the said January 1, 1900, if acquired by the proposed Pratt & Whitney Company, to be free and clear of all liabilities except those set forth in said balance sheet; and in the event of the said plant, business, and assets of the Pratt & Whitney Company being acquired by the proposed Pratt & Whitney Company, no dividends, accrued, credited, or declared upon the preferred or common stock of the present the Pratt & Whitney Company on or before January 1, 1900, to be deemed a liability of the said company, and all stock holders of the present the Pratt & Whitney Company, in writing, prior to the transfer herein contemplated, expressly to waive all right to such dividends, if any; and no dividends to have been or be declared, credited, or paid upon the said preferred or common stock subsequently to said January 1, [fol. 85] 1900, and all stockholders of the present the Pratt & Whitney Company, in writing, and prior to the transfer herein contemplated, expressly to waive all right to such dividends, if any.

Expenses of Organization

Third. It is understood and agreed by the parties hereunto that the organization of said proposed Pratt & Whitney Company shall in all respects be to the satisfaction of the second party, and that all expenses of such organization shall be borne by the proposed Pratt & Whitney Company, provided, however, that no expenses shall be incurred without the consent of the second party.

Purchase of Common Stock

Fourth. The first party and the second party do hereby covenant and agree that if the proposed Pratt & Whitney Company is organized in precisely the manner and with the property herein set forth, and if the first party shall sell or procure to be sold to the second party, 15,250 shares

of the fully paid nonassessable common stock of the said proposed corporation, at $10 per share, cash, immediately when issued, then that the second party will purchase said 15,250 shares of common stock at said price.

Guaranty of Preferred Stock

Fifth. And the said second party does further agree that if the said Pratt & Whitney Company is organized in exactly the manner and with the property herein set forth, and if the second party shall purchase the said stock, as aforesaid then that it, the second party, shall and will, in consideration of the sale to it of said common stock, enter into a contract of guaranty with the said proposed Pratt & Whitney Company, or the holders of the preferred stock of said proposed Pratt & Whitney Company, or both, that if upon any quarterly dividend day of the said proposed Pratt & Whitney Company its earnings applicable under its charter to dividends shall be insufficient to pay its preferred dividends then due and accumulated, then that it, the second party, shall and will pay to the proposed Pratt & Whitney Company such amount of money as, with the said earnings, if any, of the latter, will enable it to pay its said preferred dividends then due and accumulated, provided that the earnings of the said second party applicable under its charter to dividends shall at such time have been sufficient to enable it to pay all dividends then due and accumulated upon its preferred stock.

Winding Up

Sixth. The first party hereby covenants and agrees to recommend to present stockholders immediately after the purchase and sale of the plant and business of the present the Pratt & Whitney Company herein contemplated, to procure the said corporation to be completely and finally dissolved and wound up, according to the laws of the State of Connecticut.

Obligations Hereunder

Seventh. It is further understood and agreed that all covenants and promises herein made by the first party shall be obligatory upon the members of the said firm of Cuyler, Morgan & Company jointly and severally, and upon the heirs, executors, administrators, and assigns of them and each of them, and that the obligations of the second party hereunder shall be upon it, its successors or assigns.

[fol. 86] Execution

In witness whereof, upon the date first above written, the first party has hereunto set its hand and seal, and the second party has caused these presents to be executed under its corporate seal, by its president and secretary, thereunto duly authorized.

Cuyler, Morgan & Co., Niles-Bement-Pond Co. R. C. McKinney, President.

Attest: E. M. C. Davis, Secretary. (Corporate seal.)

The Pratt & Whitney Co. balance sheet at 31st December, 1899

Assets

Real estate and buildings, etc		$1,200,514.29
Plant (machinery, tools, and fixtures in use)		1,071,756.24
Inventory:		
Raw material and machinery in process	$420,028.00	
Finished machinery	586,056.23	
		1,006,083.23
Stock in other companies		72,877.67
Patents		40,041.33
Bills and accounts receivable		218,105.15
Cash		53,728.82
		3,663,106.73

Liabilities

Capital stock (outstanding):		
8% preferred	$1,750,000.00	
Common	1,000,000.00	
		2,750,000.00
Reserves for:		
Depreciation of plant	208,563.16	
Doubtful accounts	14,164.95	
		222,728.11
Bills and accounts payable		464,840.26
Profit and loss		225,538.36
		3,663,106.73

J. C. Stirling, Treasurer.

XV

The Pratt & Whitney Company stock at the time of its purchase and acquisition by the plaintiff in January, 1901, was worth $154,420.94, and did not cost the plaintiff any more than that sum, nor was anything other than the cash paid for it contributed by the plaintiff as consideration therefor. The value of the stock at the time it was purchased and sold to the plaintiff was said sum, $154,420.94, paid in cash for it. It afterwards apparently increased in value, but for what reasons and due to what causes does not satisfactorily appear.

XVI

The difference between the value at acquisition and the cash paid, namely, $1,370,579.06, was entered on plaintiff's books in August, 1902, as of June 30, 1902, as a part of its earned surplus and so remained throughout the years 1917, 1918, and 1919.

[fol. 87]

XVII

The commissioner in the determination and assessment of taxes for the years 1917, 1918, and 1919 decreased plaintiff's invested capital by the amount of $1,370,579.06 on account of said Pratt & Whitney stock, including said stock as an asset at the amount of $154,420.94 and no more.

XVIII

In its tax returns for each of the three years involved, plaintiff reported the 15,250 shares of Pratt & Whitney stock as an asset at an amount of $1,525,000.

XIX

The value of said Pratt & Whitney stock during the years 1917, 1918, and 1919 was no less than its value at date of acquisition in 1901.

XX

The consolidated invested capital before adjustment for inadmissibles, as determined by the commissioner, was as follows:

For the calendar year 1918	$12,727,775.00
For the calendar year 1919	13,675,858.98

The adjustments for inadmissibles were fixed by the commissioner as follows:

For the calendar year 1918:

(1) Average inadmissible assets during year	$4,225,053.97
(2) Average admissible and inadmissible assets during year	19,980,117.32
Percentage item (1) to item (2)	.211463
Invested capital before adjustment of inadmissibles	12,727,775.00
Deduction for inadmissibles, 21.1463% of $12,727,775.00	2,691,455.66

For the calendar year 1919:

(1) Average inadmissible assets during year	4,324,353.47
(2) Average admissible and inadmissible assets during year	20,522,840.91
Percentage item (1) to item (2)	.210708
Invested capital before adjustment of inadmissibles	13,675,858.98
Deduction for inadmissibles, 21.0708% of $13,675,858.98	2,881,616.86

Conclusion of Law

Upon the foregoing special findings of fact, which are made part of the judgment herein, the court decides as a conclusion of law that the plaintiff is not entitled to recover and its petition is therefore dismissed.

Judgment is rendered against plaintiff for the cost of printing the record herein, the amount thereof to be ascertained by the clerk and collected by him.

Opinion

Graham, Judge, delivered the opinion of the court:

This is a suit to recover taxes for which a claim for refund had been filed. It embraces three grounds of recovery. The first grows out of the claimed right to deduct income and excess profits taxes paid by plaintiff's branch in England to the British Government. The second involves invested capital for each of the years 1917, 1918, and 1919, and the question whether the value of certain stock

purchased by the plaintiff in 1901 should be allowed as a part of its surplus, and the third, whether the plaintiff [fol. 88] should be allowed deductions for amounts donated to the American Red Cross and other organizations of a similar character.

We will take up the last of these questions first, as to the donations to the American Red Cross. The facts and the principle of the applicable statutes are for all purposes no different from those in Consolidated Gas, Electric Light & Power Co. v. United States, 65 C. Cls. 252, 257, et seq., where a certiorari was denied on October 15, 1928, and the case of Afred J. Sweet, Inc., v. United States, decided by this court February 4, 1929. It therefore must be held that as to the credit for donations to the Red Cross and other organizations the plaintiff can not recover.

We will next take up the first question of the right to a credit for taxes paid the British Government. The right to recover depends in this instance upon whether the plaintiff kept its books on an accrual or cash basis. An examination of its books and its system of accounts by the Commissioner of Internal Revenue satisfied that official that they were kept on an accrual basis within the meaning of the statute, and he so ruled. It is admitted that no system of bookkeeping will probably be found which is on a 100% accrual basis. In almost every case where books are kept on an accrual basis, as a general principle of business, there are instances where certain accounts, small and sometimes covering a small percentage, are kept on a cash basis. We therefore concur in the ruling of the commissioner that the books were kept on an accrual basis.

The court has found that while it appears that some of the accounts of the plaintiff were kept upon a cash basis and the British account among them, it does not clearly appear what proportion was kept on the accrual basis, or that the greater proportion of its business was not kept upon the accrual basis as held by the Commissioner of Internal Revenue, and it does not satisfactorily appear that the commissioner was in error in concluding that the books were kept upon an accrual basis.

Without entering into a discussion of when a tax accrues, we conclude from what has just been said that the holding of the commissioner that the books were kept upon an accrual basis must be sustained, it not satisfactorily appear-

ing that in this he was in error, especially as it does not appear that the plaintiff presented any proof of the character of its general books of account in the United States either in 1918 or prior thereto. The presumption is in favor of the commissioner's finding and must be overcome. United States v. Rindskopf, 105 U. S. 418; United States v. Anderson, 269 U. S. 422. Where only a relatively small part has been on the cash basis it must be held that the income should have been returned upon an accrual basis. United States v. Anderson, supra; W. S. Barstow & Co., Inc. v. Bowers, 15 Fed. (2d), 75; Theodore Stanfield et al., 8 B. T. A., 787, 823; Hyams Coal Co. v. United States, 26 Fed. (2d), 805; and the Max Schott case, 5 B. T. A., 79.

Pratt and Whitney stock.—The plaintiff is here asking for a refund, which was refused, growing out of the following facts: The Commissioner of Internal Revenue in computing the income and excess-profits taxes of the plaintiff for the years 1917, 1918, and 1919, decreased the plaintiff's invested capital by reducing its earned surplus in the sum of $1,370,579.06, which represented the difference between [fol. 89] the cash paid, $154,420.94 for 15,250 shares of the stock of the Pratt & Whitney Company, which the plaintiff took over, and the par value of that stock, $100, which the plaintiff claims was its value at the time of the purchase. The plaintiff had deducted from this par value the cash purchase price actually paid and had passed the difference, the said sum of $1,370,579.06, to earned surplus. The commissioner held that it was not earned surplus, that the stock was worth the cash sum which the plaintiff paid for it at the time it was purchased and reduced its earned surplus accordingly, and upon this basis assessed a deficiency tax for each of these years.

The question is whether the commissioner was justified in the action which he took.

The court has found that the Pratt & Whitney Co. stock at the time of the purchase was worth no more than what the plaintiff paid for it, viz, $154,420.94, that it did not cost the plaintiff any more than this sum, nor was there anything other than the cash paid for it contributed by the plaintiff as consideration for it, and that the value of the stock at the time it was purchased and sold to the plaintiff was the cash sum paid for it. In view of this finding of the court the case is ruled by La Belle Iron Works v. United States (256 U. S.

377, 387, 388, 391). These considerations dispose of this branch of the plaintiff's claim, and the action of the Commissioner of Internal Revenue is upheld as to this claim.

It follows from the foregoing that the plaintiff is not entitled to recover on any one of the three claims set forth in its petition. The petition should be dismissed, and it is so ordered.

Sinnott, Judge; Green, Judge; Moss, Judge; and Booth, Chief Justice, concur.

[fol. 90] VI. JUDGMENT

At a Court of Claims held in the City of Washington on the 13th day of May, A. D., 1929, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover and its petition is therefore dismissed.

Judgment is rendered against the plaintiff for the cost of printing the record herein, the amount thereof to be ascertained by the clerk and collected by him according to law, which amount is found to be $422.22.

[fol. 91] Clerk's certificate to foregoing trnscript omitted in printing.

[fols. 92 & 93] IN THE SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1929

No. 314

NILES BEMENT POND COMPANY, Petitioner,

vs.

THE UNITED STATES

STIPULATION DESIGNATING PORTIONS OF THE RECORD TO BE OMITTED IN PRINTING

It is hereby stipulated and agreed, by and between petitioner by its counsel and the Solicitor General, as counsel

for the United States, that the following portions of the record certified by the Assistant Clerk of the Court of Claims, in the above entitled cause, to-wit, Pages 27 to 78, inclusive, of the amended petition to the Court of Claims, consisting of Exhibits "A" to "D," inclusive, attached to said petition, may be omitted from the record to be printed herein, for the reason that said exhibits are of no relevancy or materiality to the questions presented by the petition for certiorari herein.

Dated this 12th day of August, A. D. 1929.

Karl O. Loos, Counsel for Petitioner. Charles E. Hughes, Jr., Solicitor General.

Endorsed on cover: File No. 34,445. Court of Claims. Term No. 314. Niles Bement Pond Company, petitioner, vs. The United States. Petition for writ of certiorari and exhibit thereto. Filed August 9, 1929. File No. 34,445.

(8952)

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 21, 1929

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

FILED
AUG 30 1929
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

No. 314.

NILES BEMENT POND COMPANY, *Petitioner,*

vs.

THE UNITED STATES, *Respondent.*

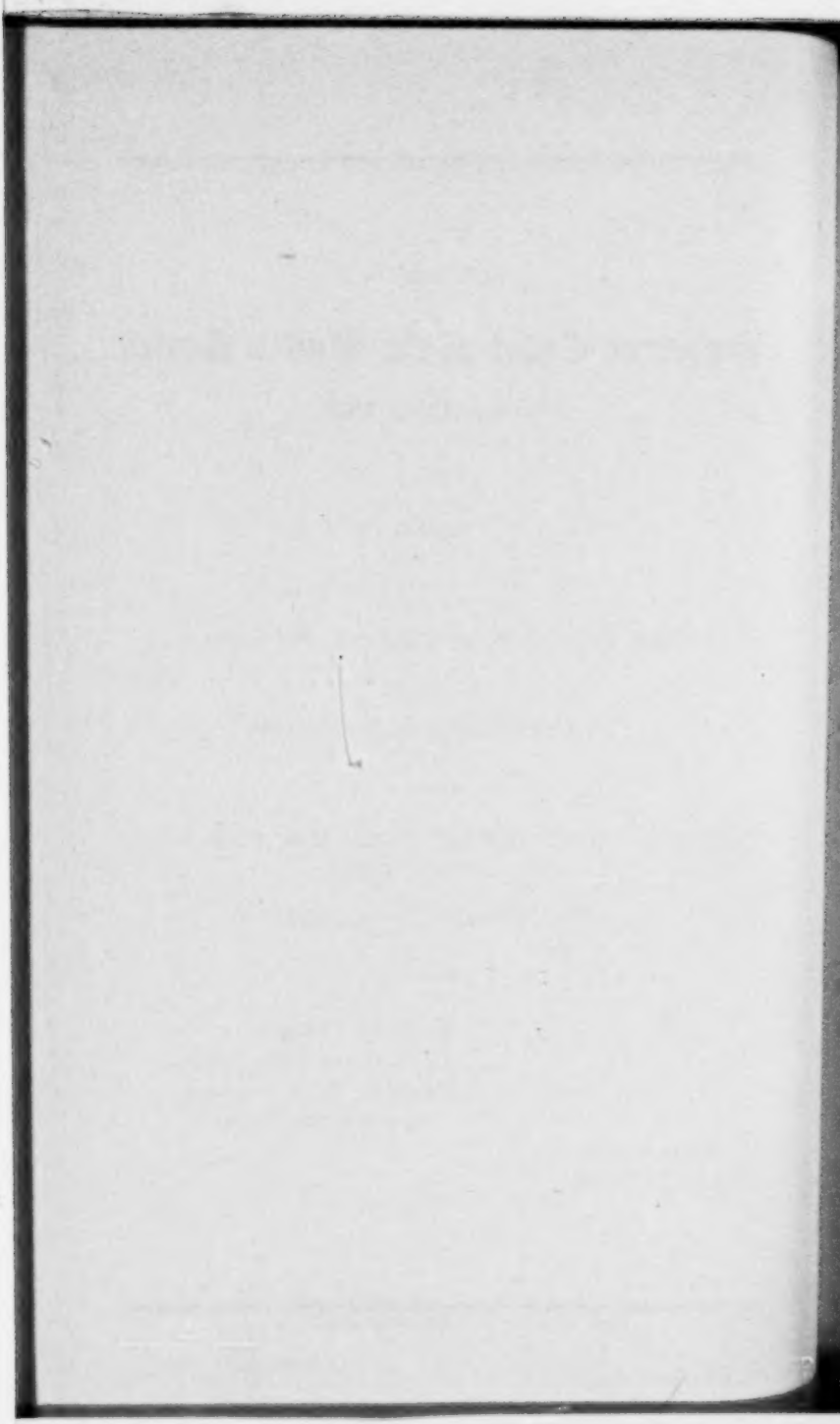
BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

(The Jurisdiction Included.)

KARL D. LOOS,
E. BARRETT PRETTYMAN,
PRESTON B. KAVANAGH,
Counsel for Petitioner.

Washington, D. C.,
August 28, 1929.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.



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IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

No. 314.

NILES BEMENT POND COMPANY, *Petitioner,*

vs.

THE UNITED STATES, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

(The Jurisdiction Included.)

I.

THE OPINION OF THE COURT BELOW.

The opinion in the Court of Claims is not yet reported. The opinion was rendered by the Court of Claims May 13, 1929 (R. 27).

II.

JURISDICTION.

1. The statutory provision believed to sustain jurisdiction is Section 3(b) of the Act of February 13, 1925; Chap. 229, 43 Stat. L. 939; U. S. C. Title 28, Sec. 288 (b).

2. The date of the judgment sought to be reviewed is May 13, 1929 (R. 40). The petition for certiorari was filed August 9, 1929 (R. 41).

3. This was a case in the Court of Claims instituted by petition to recover federal income and profits taxes alleged to have been erroneously collected (R. 1). General traverse was filed (R. 26), the case was heard upon the evidence and the Court made certain findings of fact (R. 27), rendered an opinion (R. 37) and entered judgment against the petitioner dismissing the petition (R. 40).

4. Cases believed to sustain the jurisdiction are:

Southern Pacific Co. v. United States, 270 U. S. 103;
Culver v. United States, 269 U. S. 550, 271 U. S. 315;
Kornhauser v. United States, 273 U. S. 692, 276 U. S. 145.

III.

STATEMENT OF THE CASE.

This suit was instituted in the Court of Claims to recover corporate income and profits taxes for 1917 and 1918 alleged to have been erroneously and illegally collected by respondent from petitioner. The question here presented is:

Whether petitioner was entitled in 1918 to a credit under Section 238 (a) of the Revenue Act of 1918 (Chap. 18, 40 Stat. L. 1057, 1080) for certain British income taxes and excess profits duties paid during 1918, where the first information received by petitioner as to the amount of such taxes so payable was received in 1918 and the taxes were first entered upon petitioner's books during 1918 as an expense for that year in accordance with the method of accounting regularly employed by petitioner in keeping its books.

The findings of fact upon this question (Nos. V to XI, inclusive), show (R. 28-30):

During the year 1918 petitioner paid to the Government of Great Britain an income tax for the year ending April 5, 1918, and also an excess profits duty for the accounting period ended December 31, 1916 (R. 28). These taxes were paid pursuant to notices, one dated January 24, 1918, and the other dated January 19, 1918, which notices were the first notice, assessment, demand or information received by petitioner as to the amount of the taxes so payable (R. 28). Under the method of accounting regularly employed by petitioner in keeping its books throughout the year 1918, the accounting for expenses of its London Office was on a cash disbursements basis and no accruals were made for any such expenses in advance of their payment (R. 29). The British taxes paid in 1918 were expenses of petitioner's London Office and were entered on the petitioner's books of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping petitioner's books (R. 29). Except for expenses of the London Office and some additional small items where the cash basis was reflected, petitioner's books were kept on the

accrual basis and the principal and dominant purpose and plan of its accounts were to show income upon an accrual basis as the general and controlling character of the accounts (R. 29-30).

Petitioner took the credit in 1918. The Commissioner of Internal Revenue disallowed the credit thus taken, thereby increasing the tax payable for that year. The tax was paid by petitioner and suit was filed by it in the Court of Claims for recovery. The Court of Claims held that credit was not properly taken in 1918 and dismissed the petition.

It is not disputed that these taxes and duties were of the character allowable as a credit under Section 238 (a) of the Revenue Act of 1918. The question is whether credit may be taken (and the statutory provisions are the same as to the deduction of expenses) in the year of payment, when the method of accounting regularly employed calls for entry in the books of account on a cash disbursements basis, the majority of the taxpayer's accounts being upon an accrual basis but a considerable section of such accounts, as in this case all the London Office expense accounts of this petitioner, being on a cash basis.

IV.

SPECIFICATION OF ERRORS.

1. The Court of Claims erred in holding that the statutory phrase "method of accounting regularly employed in keeping the books of such taxpayer," describes only two systems of accounts, one a "strict cash basis" and the other a "strict accrual basis."

2. The Court of Claims erred in holding, in effect, that books must be kept and income returned upon either a strict cash basis or a strict accrual basis.

3. The Court of Claims erred in holding that petitioner was not entitled to a credit in 1918 for British taxes under Section 238 (a) of the Revenue Act of 1918, although it found as facts that such taxes were paid in 1918, and were entered on petitioner's books of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping such books.

4. The Court of Claims erred in considering as material the fact that accounts other than the London Office accounts to which the British taxes belonged, were kept on the "accrual basis," and in holding that under a method of accounting upon a mixed accrual and cash disbursements basis a credit was allowable according to the basis of the majority of the accounts regardless of the basis of the particular account in which the expenditure belonged.

5. The Court of Claims erred in denying to petitioner its claim for credit for British taxes paid in 1918.

6. The Court of Claims erred in dismissing the petition and in entering judgment for the defendant.

V.

ARGUMENT.

Summary of the Argument.

The case turns upon the meaning of the phrase "method of accounting regularly employed in keeping the books of such taxpayer," as it appears in Section 212 (b) of the Revenue Act of 1918. The question is important because the phrase appears in all the Revenue Acts since 1918 and governs the deduction of all expenses and the application of all credits. It has not

been decided by this Court and much confusion exists in the lower court and Board of Tax Appeals decisions in regard to it. Many taxpayers, especially corporations, are concerned in the answer.

The Court of Claims held that the phrase includes only two systems of bookkeeping, one a strict cash basis and the other a strict accrual basis, and that all deductions and credits must be made according to the predominant purpose of the accounts. This, we insist, was erroneous because it contradicts the language of the statute, runs counter to Departmental construction and to several decisions of this Court. No objection has, or can now, be made that the method of accounting used by this taxpayer failed to reflect accurately its income.

Where, as in this case, the accounts are, generally speaking, on an accrual basis but certain sets of accounts, due to some compelling peculiar condition, such as the operation of this petitioner's London office, are upon a cash basis, items entered on the books on a cash basis in accordance with that method should be deducted or credited on income tax returns in the year when they are paid.

The Statute.

Section 238 (a) of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1080) provides:

> Section 238 (a). "That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States."

The petitioner's case depends upon the construction of the statutory provisions defining the term "paid," which provisions in the Revenue Act of 1918 are as follows:

> Sec. 200. "The term 'paid' for the purposes of the deductions and credits under this title, means 'paid or accrued,' or 'paid or incurred,' and the terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212."
>
> Sec. 212 (b). "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income * * *."

The Question of Statutory Construction Here Presented is an Important One Not Decided by This Court.

Importance of question.

The sections above quoted not only govern the application of the term "paid," "incurred" and "accrued" to foreign tax credits, but also to all other expenditures which may be allowable as deductions from income or as credits of another character. Therefore, the construction of these sections of the statute is of importance in connection with deductions and credits of every character and is not limited to the subject of foreign tax credits.

The phrase "method of accounting regularly employed in keeping the books of such taxpayer" (Sec. 212 (b) of Revenue Act of 1918) "according to" which the terms "paid or incurred" and "paid or accrued" shall be construed (Sec. 200 of the Revenue Act of 1918), is contained in all the Revenue Acts subsequent to the 1918 Act, including the statute now in force. Sections 200 and 212 of the Revenue Act of 1921, c. 136, 42 Stat. 227; Sections 200 and 212 of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sections 200 and 212 of the Revenue Act of 1926, c. 27, 44 Stat. 9; and Sections 41 and 43 of the Revenue Act of 1928, c. 852, 45 Stat. 795. The question is therefore of continuing importance in respect of taxes for all years since 1918, and for future years so long as the statute retains its present provisions.

THE QUESTION NOT DECIDED BY THIS COURT.

When the method of accounting is on an accrual basis and the book entries in question are made as accruals or should be so made under the method of accounting regularly employed, it has been decided that the statute requires the deduction or credit to be taken in the year of accrual. *United States v. Anderson* and *United States vs. Yale & Towne Company*, 269 U. S. 422, reversing *Anderson v. United States*, 60 Ct. Cls. 106, and *Yale & Towne v. United States*, 60 Ct. Cls. 440; *American National Company vs. United States*, 274 U. S. 99.

When the method of accounting is on a cash receipts and disbursements basis, and the book entries in question are made as cash transactions or should be so made under the method of accounting regularly employed, it has been decided that the statute requires

the deduction or credit to be taken in the year of payment. *United States v. Mitchell*, 271 U. S. 9, reversing *Mitchell vs. United States*, 60 Ct. Cls. 451.

When the method of accounting is on a mixed accrual and cash disbursements basis, containing groups of accounts on the cash basis but a majority of the accounts on an accrual basis, and when the book entries in question are and should be on the cash basis under the method of accounting regularly employed, it has not been decided whether the deductions and credits should be taken in the year of payment in accordance with the basis of the particular accounts to which the expenditure belongs under the method of accounting regularly employed, or in the year of accrual in accordance with the basis of the majority of the accounts but contrary to the basis prescribed by the method of accounting regularly employed.

We emphasize that in this case the British tax payments were not isolated items in a set of accounts on the accrual basis but were a part of the London office expense accounts, all of which were on a cash disbursements basis under the method of accounting regularly employed by the petitioner (R. 29, findings IX and X).

CONFUSION AND UNCERTAINTY IN ABSENCE OF AUTHORITATIVE DECISION BY THIS COURT.

Much confusion and uncertainty exist in the application of these statutory provisions to mixed accounting systems. This Court's decision in *United States v. Anderson*, 269 U. S. 422; and *American National Company v. United States*, 274 U. S. 99, applied to the Revenue Act of 1916, and only the decision in *United States v. Mitchell*, 271 U. S. 9, applied to the Revenue Act of 1918. In all these cases, however, the Court

emphasized that the terms of the statute meant the method of accounting which was employed by the taxpayer and we think made it clear that such methods of accounting and not some abstract rule of accrual or cash basis was to govern the year in which deductions or credits might be taken. Notwithstanding these decisions of this Court, there has been a persistent tendency on the part of the Commissioner of Internal Revenue and the lower courts arbitrarily to divide all accounting systems into two methods, one a cash receipts and disbursements basis and the other an accrual basis.

The Court of Claims in its decision herein cited this Court's decision in the *Anderson* case as authority for the proposition that when only a part of the accounts are on a cash basis, all deductions and credits must be taken on the accrual basis regardless of the method of accounting employed. We think the Court did not intend to sanction any such arbitrary departure from the method of accounting regularly employed by the taxpayer.

The decisions of the federal district courts and the circuit courts of appeals involving these statutory provisions (*Stieff v. Tait*, 26 Fed. (2d) 489; *Hyams Coal Co. v. United States*, 26 Fed. (2d) 805; *Bacon Grain Co. v. Reinecke*, 26 Fed. (2d) 705; *American Code Company v. Commissioner*, 30 Fed. (2d) 222; *Consolidated Tea Co. v. Bowers*, 19 Fed. (2d) 382), do not lay down any rule for application to a mixed system of accounting.

The *Hyams Coal Company* and the *Bacon Grain Company* cases perhaps intimate that a strict accrual or strict cash basis must be applied rather than the basis of the accounting system actually employed. If

such is the view expressed, it is, we submit, contrary to the mandate of the statute and in conflict with the views expressed by this Court.

The decisions of the Board of Tax Appeals are in considerable confusion on this question. It has stated that a taxpayer must follow "one of the two alternative bases provided by stat te for keeping accounts." *Henry Reubel, Executor,* 1 B. T. A. 676. See also *Coatesville Boiler Works,* 9 B. T. A. 1242. This rule was explained by the Board in a later ruling as follows:

> "The reason for such holding was that such a method resulted in a distortion of income as not having a regular and consistent method but leaving it uncertain as to how various items might be treated, and making it difficult, if not impossible, to verify the correctness of the result. * * * The basis of the conclusion reached by us in the cases cited above was the necessity to require methods of accounting which would clearly reflect income. To so construe those decisions as to lay down a hard and fast rule requiring every business owned by the same individual or the same partnership to use the same method of accounting irrespective of whether it correctly reflects income would be to defeat the object sought." (*Joseph Stern, et al.,* 14 B. T. A. 838, 843.)

As we shall later point out in this brief no contention has been made by the Government that this petitioner's method of accounting did not clearly reflect the income, and thus the petitioner's method does not violate the rule of the Board.

In other cases the Board has said:

> "Clearly the statute does not say what the method of accounting should be. It does not single

out one of two methods to the exclusion of all others." (*Morris-Poston Coal Company*, 13 B. T. A. 344, 349.)

And in *Great Northern Railway Company*, 8 B. T. A. 225, 268, the Board in approving a mixed accounting method kept in accordance with rules prescribed by the Interstate Commerce Commission said:

> "The statute does not lay down two alternative bases for keeping accounts and making returns of income." (*Great Northern Railway Company*, 8 B. T. A. 225, 268.)

To remove the prevailing confusion and uncertainty, a decision of this Court is needed on the meaning of the statutory provisions here in question when applied to an accounting system on a mixed accrual and cash basis.

Many taxpayers interested.

Practically all systems of accounting for any substantial amount of business are on a mixed basis (R. 38). (Opinion, p. 9.)

Practical considerations of a compelling nature frequently require a mixed system of accounts. Kohler on Federal Income Taxes (1927 p. 46) says, "Perhaps no set of books exists in which all accounts are handled on a strict accrual basis." The manufacturing and general financial accounts of any large business must be kept on an accrual system in order to permit effective management and control. But if the refinements of an accrual system are extended to every department

and section of an extensive business, the accounting system becomes unwieldy and burdensome, particularly when parts of the accounts must be kept at points distant from the principal accounting office. Therefore, certain groups of accounts are often kept on a cash basis.

So in this case the accounts of petitioner's office in a distant foreign country were kept on a cash basis. That group of accounts always has been kept on such basis and doubtless always will be. Many other companies have similar situations requiring the use of mixed accounting systems.

The rule governing allowable deductions and credits under such accounting systems is therefore of interest and often of importance to large numbers of individuals and corporations whose accounts are so kept. Its determination is of importance not only in deciding controversies regarding taxes but also that taxpayers may know whether the Revenue Laws permit the keeping of books on a basis other than the strict accrual basis or the strict cash basis.

The Statute Has Been Misconstrued by the Court of Claims.

The pertinent statutory provisions previously quoted in full, *supra*, may be summarized as follows:

> "The term 'paid' * * * means 'paid or accrued' or 'paid or incurred' * * * (which terms) shall be construed according to the method of accounting upon the basis of which the net income is computed * * *. The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayers."

Further abbreviating, the statute requires that the terms "paid or accrued" and "paid or incurred" shall be construed according to the method of accounting regularly employed in keeping the taxpayer's books.

The Court of Claims construed these statutory provisions as follows:

> "The right to recover depends in this instance upon whether the plaintiff kept its books on an accrual or cash basis. An examination of its books and its system of accounts by the Commissioner of Internal Revenue satisfied that official that they were kept on an accrual basis *within the meaning of the statute*, and he so ruled.
>
> "The Court has found that while it appears that some of the accounts of the plaintiff were kept upon a cash basis *and the British account among them*, it does not clearly appear what proportion was kept on the accrual basis, or that the greater proportion of its business was not kept upon the accrual basis * * *.
>
> "Where only a relatively small part has been on the cash basis it must be held that the income should have been returned upon an accrual basis." (Italics ours.) (R. 38-39.)

We submit the Court of Claims erred in this construction.

The phraseology of the statute.

It seems to us that the terms of the statute are both simple and plain. The words are "the method of accounting regularly employed in keeping the books of such taxpayer." Nothing mysterious or difficult appears there. In fact, more simple English language would be difficult to select. One single qualification appears to that clause, and that is that the method

employed must clearly reflect the income, which qualification we shall later discuss.

The statute does not require that income shall be returned upon the cash basis or upon the accrual basis or upon the basis upon which the majority of the accounts may be kept. The statute uses neither the term "cash" nor the term "accrual." It requires only that the return of income shall be "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer." The language of the statute plainly negatives the construction placed thereon by the Court of Claims. It seems obvious that the lower Court has overlooked and failed to give effect to the phraseology of the statute, in holding that the books were "kept on an accrual basis *within the meaning of the statute*" (R. 38) and that the statute required the income to be returned upon an accrual basis "where only a relatively small part" of the accounts are kept on the cash basis.

CONTEMPORANEOUS DEPARTMENTAL CONSTRUCTION.

The regulations promulgated by the Treasury Department under the Revenue Act of 1918 recognized that the statute did not attempt to prescribe alternative methods of accounting or any particular method of accounting to the exclusion of other methods. Regulations No. 45, promulgated under the 1918 Act, contained as part of Article 24 the following opening sentence, under the heading "Methods of Accounting":

> "It is recognized that no uniform method of accounting can be prescribed for all taxpayers and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose."

Exactly the same sentence is contained in the regulations issued under the Revenue Acts of 1921, 1924, 1926, and 1928. (Art. 24 of Regs. 62, 65 and 69 and Art. 323 of Regs. 74.)

This contemporaneous departmental construction, announced soon after the enactment of the Revenue Act of 1918 and consistently adhered to in the construction of similar provisions of subsequent Revenue Acts including the one now in force, clearly refutes the interpretation placed upon the statute by the Court of Claims in its decision in this case.

The decisions of this Court.

In the cases in which phases of this question have come before this Court, the accounting method actually employed by the taxpayer has been held to be controlling. To this effect were the decisions in *United States vs. Anderson*, and *United States vs. Yale & Towne Co.*, 269 U. S. 422, *American National Company vs. United States*, 274 U. S. 99, *United States vs. Mitchell*, 271 U. S. 9, *Fourth and Central Trust Company, Executor, vs. United States*, 278 U. S. 604, denying certiorari in case reported at 65 Ct. Cls. 96.

In the opinion in the Anderson and Yale & Towne cases, *supra*, the Court said:

> "It should be noted that Sec. 13(d) makes no use of the word 'accrue' or 'accrual' *but merely provides for a return upon the basis upon which the taxpayer's accounts are kept*, if it reflects income—which is precisely the return insisted upon by the Government. We do not think that the Treasury decision contemplated a return on any other basis when it used the terms 'accrued' and 'accrual' and provided for the deduction by the

taxpayer of items 'accrued on their books.'" (269 U. S. 422, 441)

In U. S. vs. Mitchell, *supra*, the Court said, p. 12:

> "The return shows that it was made on the basis of income actually received in 1919. This indicates that the accounts were kept on the basis of actual receipts and disbursements, and there is nothing in the record to show that any other method was employed. The burden is on the executors to establish the invalidity of the tax. *United States v. Anderson, supra.* They have not shown that their books were kept on the accrual basis. Assuming, as we must, that the accounts of the estate were kept on the basis of actual receipts and disbursements, the executors were required to make return on that basis."

Thus in all of the decided cases the accounting method actually employed by the taxpayer has been held controlling in determining whether deductions or credits shall be taken when paid or when accrued. None of these cases are authority for the proposition announced by the Court of Claims in this case that the basis of the majority of the accounts must govern and the basis actually employed in accordance with the regular accounting method must be ignored. Such a proposition is distinctly negatived by the opinions of this Court in the cases above cited and by the uniform adherence of this Court to the method of accounting actually employed in deciding these questions.

The Lower Court's Decision Cannot Be Supported on Ground that Petitioner's Method of Accounting did not Clearly Reflect Income.

As has been shown, the rule clearly contained in the statute is that the method of accounting regularly em-

ployed governs. That method of accounting cannot be ignored or modified except upon one condition, namely, that such method of accounting does not clearly reflect the income, in which event the Commissioner is authorized to make the computation in such manner and upon such basis as in his opinion does clearly reflect the income.

That condition has no application in this case. The Court of Claims did not rest its decision upon that provision of the statute and at no time in the progress of this case, either before the Bureau of Internal Revenue or before the Court of Claims, was there ever any contention that petitioner's method of accounting did not clearly reflect income.

Furthermore, this is a question of credit of foreign income taxes against domestic taxes and not a deduction of an expense from gross income and, therefore, the question of clearly reflecting income cannot and does not arise in this case.

Should the question be considered pertinent, if raised in this Court for the first time, the record clearly shows that petitioner's method of accounting, as a method, was accepted by the Commissioner of Internal Revenue for all other years (R. 29). The findings of fact show that for the year 1919, the British income tax for the year subsequent to the British income tax involved in this case, was paid in 1919 and claimed as a credit in that year and so allowed by the Government (R. 29). It is also shown that the British income tax for the next year, ending April 5, 1920, was not paid until 1924 and that the Commissioner made no adjustment transferring this payment to the account of earlier years which would have been necessitated had the petitioner's method of accounting been re-

jected. Moreover, this item was but one of the London office expenses, all of which were treated upon the cash basis. None of the other numerous adjustments which would have been necessary in petitioner's London office accounts, had petitioner's method of accounting been rejected as not clearly reflecting income, were made or even proposed by the Commissioner of Internal Revenue or by any other Government officer.

Moreover, there was at one time a Departmental Regulation specifically approving the precise act of this petitioner now complained of. In Regulations 33, Article 158, issued January 5, 1914, under the Revenue Act of 1913, the Treasury Department held that deductions might be taken when "so entered on the books of the corporation as to constitute a liability against the assets of the corporation," with the sole and specific exceptions of taxes and losses, which, it was provided, must be deducted when paid. "Deductions for taxes, however," said the Regulations, "should be the aggregate of the amounts *actually paid,* as shown on the cash book of the corporation." Here was a mixed basis of deduction clearly recommended, and even required, as a variation of the accrual method, by the Treasury Department over the signature of the Secretary of the Treasury.

It is not our position that an entry in the books of account is controlling if that entry is contrary to the accounting system and not the kind of entry that the method of accounting regularly employed requires. But if the entry is in accordance with the method of accounting regularly employed, and in this case the findings of fact so show (R. 3), the statute requires that the actual entry must be given effect and the deduction or credit of that item must be determined in accordance with the entry.

The situation here presented is not that of an isolated entry on a cash basis in an accounting system on a strict accrual basis. Here a separate and distinct group of accounts, those pertaining to the London office of petitioner, were regularly on a cash basis. The principal accounts in the United States were on an accrual basis; some of the minor domestic accounts were also on a cash basis. Thus petitioner had a definite and well formulated method of accounting devised to meet the requirements of its business. The basis for each class of accounts was uniformly and consistently applied. It has never heretofore been suggested and it cannot be successfully contended that this method of accounting failed clearly to reflect petitioner's income.

Conclusion.

The correct construction of the statute is that the terms "paid or incurred" and "paid or accrued," wherever used in the Act, mean *paid* for all items which under the taxpayer's method of accounting are regularly entered on the cash disbursements basis; that they mean *incurred* or *accrued* for all items which under the taxpayer's method of accounting are regularly entered on the accrual basis; so long as no objection is made that the accounts thus kept do not reflect accurately the income. Applying the rule to this case, the term "paid" in section 238(a) of the Revenue Act of 1918 means "paid" and not "accrued" in relation to the British taxes here in question, for those British tax payments were entered on petitioner's books on the cash disbursements basis in accordance with the method of accounting regularly employed. The foreign tax payments, paid in 1918, are therefore allowable as a credit for that year.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, in order that the construction of an important provision of the Revenue Acts may be definitely settled and that an error in the construction and application of such statutory provision may be corrected; and to such end that a writ of certiorari should be granted and this Court should review the decision of the Court of Claims and finally reverse it.

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Counsel for Petitioner.

Washington, D. C.,
August 28, 1929.

FILE COPY

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DEC 30
CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM 1929.

No. 314.

NILES BEMENT POND COMPANY, *Petitioner*,

vs.

THE UNITED STATES, *Respondent*.

BRIEF OF PETITIONER.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1929.

No. 314.

NILES BEMENT POND COMPANY, *Petitioner*,

vs.

THE UNITED STATES, *Respondent*.

BRIEF OF PETITIONER.

I.

THE OPINION OF THE COURT BELOW.

The opinion in the Court of Claims is not yet reported. The opinion was rendered by the Court of Claims May 13, 1929, (R. 27).

II.

STATEMENT OF THE CASE.

This suit was instituted in the Court of Claims to recover corporate income and profits taxes for 1918

alleged to have been erroneously and illegally collected by respondent from petitioner. The Court of Claims dismissed the petition and rendered judgment against the petitioner (R. 40). Petition for certiorari was granted October 21, 1929.

The question here presented is:

Whether petitioner was entitled in 1918 to a credit under Section 238 (a) of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1080) for certain British income taxes and excess profits duties paid during 1918, where the first information received by petitioner as to the amount of such taxes so payable was received in 1918 and the taxes were first entered upon petitioner's books during 1918 as an expense for that year in accordance with the method of accounting regularly employed by petitioner in keeping its books.

The only portions of the pleadings, findings and opinion relating to this question (one of three separate claims originally presented, the other two having been abandoned) are: amended petition, paragraphs 8 to 13 (R. 13-19); and paragraphs 20-25 (R. 25-26); findings of fact Nos. I-XI, inclusive (R. 27-30); and that part of the opinion beginning on page 37 and concluding at the end of the first paragraph on page 39 of the Record.

The findings of fact upon the question here presented (Nos. V to XI, inclusive), show (R. 28-30):

During the year 1918 petitioner paid to the Government of Great Britain an income tax for the year ending April 5, 1918, and also an excess profits duty for the accounting period ended December 31, 1916 (R. 28). These taxes were paid pursuant to notices, one dated January 24, 1918, and the other dated January 19, 1918, which notices were the first notice, assessment,

demand or information received by petitioner as to the amount of the taxes so payable (R. 28). Under the method of accounting regularly employed by petitioner in keeping its books throughout the year 1918, the accounting for expenses of its London Office was on a cash disbursements basis and no accruals were made for any such expenses in advance of their payment (R. 29). The British taxes paid in 1918 were expenses of petitioner's London Office and were entered on the petitioner's books of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping petitioner's books (R. 29). Except for expenses of the London Office and some additional small items where the cash basis was reflected, petitioner's books were kept on the accrual basis and the principal and dominant purpose and plan of its accounts were to show income upon an accrual basis as the general and controlling character of the accounts (R. 29-30).

Petitioner took the credit in 1918. The Commissioner of Internal Revenue disallowed the credit thus taken, thereby increasing the tax payable for that year. The tax was paid by petitioner and suit was filed by it in the Court of Claims for recovery. The Court of Claims held that credit was not properly taken in 1918 and dismissed the petition.

It is not disputed that these taxes and duties were of the character allowable as a credit under Section 238 (a) of the Revenue Act of 1918. The question is whether credit may be taken (and the statutory provisions are the same as to the deduction of expenses) in the year of payment, when the method of accounting regularly employed calls for entry in the books of account on a cash disbursements basis, the majority

of the taxpayer's accounts being upon an accrual basis but a considerable section of such accounts, as in this case all the London Office expense accounts of this petitioner, being on a cash basis.

III.

SPECIFICATION OF ERRORS.

1. The Court of Claims erred in holding that the statutory phrase "method of accounting regularly employed in keeping the books of such taxpayer," describes only two systems of accounts, one a "strict cash basis" and the other a "strict accrual basis".

2. The Court of Claims erred in holding, in effect, that books must be kept and income returned upon either a strict cash basis or a strict accrual basis.

3. The Court of Claims erred in holding that petitioner was not entitled to a credit in 1918 for British taxes under Section 238 (a) of the Revenue Act of 1918, although it found as facts that such taxes were paid in 1918, and were entered on petitioner's books of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping such books.

4. The Court of Claims erred in considering as material the fact that accounts other than the London Office accounts to which the British taxes belonged, were kept on the "accrual basis," and in holding that under a method of accounting upon a mixed accrual and cash disbursements basis a credit was allowable according to the basis of the majority of the accounts regardless of the basis of the particular account in which the expenditure belonged.

5. The Court of Claims erred in denying to petitioner its claim for credit for British taxes paid in 1918.

6. The Court of Claims erred in dismissing the petition and in entering judgment for the defendant.

IV.

SUMMARY OF ARGUMENT.

The case turns upon the meaning of the phrase "method of accounting regularly employed in keeping the books of such taxpayer", as it appears in section 212 (b) of the Revenue Act of 1918.

This phrase was first adopted in the Revenue Act of 1918 which for the first time required returns on the basis of the method of accounting employed, the statutes theretofore having required returns on the cash receipts and disbursements basis, although under the 1916 Act corporations were accorded the option of reporting upon the basis upon which its accounts were kept. The statutory history shows that Congress deliberately refrained from prescribing any inflexible method of accounting and the Act clearly expresses the intent of Congress to make the books of account, as kept in accordance with the method of accounting regularly employed, the basis for return of income.

This Court has not decided the rule applicable under mixed systems of accounting such as the one in this case, but in several decisions relating to this subject, under both the 1918 and 1916 Acts, has held the taxpayer's method of accounting controlling in determining whether deductions and credits should be taken when paid or when accrued.

The Court of Claims held that the phrase includes only two systems of bookkeeping, one a strict cash basis and the other a strict accrual basis, and that all deductions and credits must be made according to the

predominant purpose of the account. This, we insist, was erroneous because it ignores the phraseology of the statute; it conflicts with the contemporaneous departmental construction of the statute; and it conflicts with principles announced by this Court in several decisions.

The lower court's decision cannot be supported on the ground that petitioner's method of accounting did not clearly reflect income. No such objection was ever advanced in the lower court or at any other time during the progress of this case before the Bureau of Internal Revenue and it is too late to raise such an objection for the first time in this Court. If the point be considered, it is plainly without merit, because there has been no finding by the Commissioner that petitioner's method of accounting did not clearly reflect income; none of the numerous adjustments necessary if petitioner's method had required changing, have been made; and the record clearly shows that petitioner's method of accounting, as a method, was accepted by the Commissioner. Mixed accounting methods are frequently necessary to meet special requirements of a business and they are commonly used. In plaintiff's method of accounting each group of accounts had a definite basis and the basis for each class of accounts was uniformly and consistently applied. It cannot be successfully charged that such an accounting method failed clearly to reflect income.

Where, as in this case, the accounts, generally speaking are on an accrual basis but certain sets of accounts, due to some compelling peculiar condition, such as the operation of this petitioner's London Office, are upon a cash basis, items entered on the books on a cash basis, in accordance with that method, should be

deducted or credited on income tax returns in the year when they are paid.

V.

ARGUMENT.

A. The Statute.

Section 238 (a) of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1080) under which petitioner claims credit for certain British income taxes and excess profits duties paid during 1918, provides:

> Section 238 (a). "That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States."

The petitioner's case depends upon the construction of the statutory provisions defining the term "paid," which provisions in the Revenue Act of 1918 are as follows:

> Sec. 200. "The term 'paid' for the purposes of the deductions and credits under this title, means 'paid or accrued', or 'paid or incurred', and the terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212."

> Sec. 212 (b). "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as

> the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income * * *."

The two sections above quoted may be summarized as follows:

> "The term 'paid' * * * means 'paid or accrued' or 'paid or incurred' * * * (which terms) shall be construed according to the method of accounting upon the basis of which the net income is computed * * *. The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayers."

Further abbreviating, the statute requires that the terms "paid or accrued" and "paid or incurred" shall be construed according to the method of accounting regularly employed in keeping the taxpayer's books.

The Sections of the statute above quoted are from the Revenue Act of 1918. Similar provisions employing the phrase "method of accounting regularly employed in keeping the books of such taxpayer" are contained in all subsequent revenue acts, including the statute now in force. (Secs. 200 and 212 of the Revenue Act of 1921, c. 136, 42 Stat. 227; Sections 200 and 212 of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sections 200 and 212 of the Revenue Act of 1926, c. 27, 44 Stat. 9; and Sections 41 and 43 of the Revenue Act of 1928, c. 852, 45 Stat. 795).

B. The Statutory History.

The Revenue Act of 1909 (c. 6, Sec. 38, 36 Stat. 11, 112) required that income should be returned on a cash receipts and disbursements basis and its terms did not permit the accrual of either income or expense items, regardless of the basis on which the books of account of a taxpayer might be kept. The Revenue Act of 1913 (c. 16, Sec. 11, Sub-division G, 38 Stat. 114, 172) continued this requirement of a return on a cash receipts and disbursements basis regardless of the method of accounting which might be used by the taxpayer.

The Revenue Act of 1916 (c. 63, 39 Stat. 756) continued the provision for a return on a cash receipts and disbursements basis (Sec. 12 (a)) but introduced an alternative provision (Sec. 13 (d), appendix p. 31) permitting a corporation "keeping accounts upon any basis other than that of actual receipts and disbursements", to make its return "upon the basis upon which its accounts are kept."

The Revenue Act of 1917 (c. 63, 40 Stat. 300) made no change in these provisions and the Revenue Act of 1916 remained in force and unamended in these respects.

Thus prior to the Revenue Act of 1918, Congress, after having required the cash basis as the sole basis for making returns of income under the first two Revenue Acts, modified that requirement by permitting (for corporations but not for individuals) in the 1916 Act a return on the basis upon which the accounts were kept when that basis was other than actual receipts and disbursements.

The Revenue Act of 1918 took the remaining step toward a complete reversal of the earlier requirements

and not only permitted returns on a basis other than actual receipts and disbursements but required (for both corporations and individuals) that the returns be made on the basis of and in accordance with the method of accounting regularly employed in keeping the books of the taxpayer.

Section 13 (d) of the 1916 Act did not use the word "accrual" or any similar term but allowed the return "upon the basis upon which its accounts are kept", phraseology which evidently contemplated varying systems or methods of accounting. Under authority of this provision of the statute, Treasury Decision 2433 (Appendix p. 31) was promulgated January 8, 1917, prescribing regulations governing returns made on other than a cash receipts and disbursements basis. In that Treasury Decision, the terms "accrual", "reserves" and similar terms were used and the Department has contended that under that Treasury Decision a taxpayer was required either to make its return upon the strict cash receipts and disbursements basis or upon such accrual basis as the Commissioner might require. In framing the 1918 Act, Congress did not adopt the phraseology of the Treasury Decision but used the phrase "method of accounting regularly employed in keeping the books of such taxpayer." This phraseology, like that of the 1916 Act, obviously contemplated different and varying methods of accounting adaptable to the peculiar requirements of each taxpayer's business. This view was recognized in the regulations first issued under the 1918 Act and in regulations issued under subsequent Acts containing like phraseology.

The 1918 Act, in the form in which it first passed the House, (H. R. 12863, 65th Congress, 2nd Session) did

not contain any definition of the word "paid" or of the terms "paid or incurred" or "paid or accrued". It did contain Section 212 (b) substantially in its final form providing for the computation of net income in accordance with the method of accounting regularly employed in keeping the books. The Senate added the provision in Section 200 defining the terms "paid or incurred" and "paid or accrued" and the conferees added the definition of the term "paid". (H. R. 12863, Committee Print, as agreed to in Conference, Volume 33, House of Representatives Bills, 65th Congress; Appendix p. 34.)

With respect to the conference amendment to Section 200, the Conference Report (House Report No. 1037, 65th Congress) stated (p. 44):

> "This amendment provides that the terms 'paid or incurred' and 'paid or accrued' when used in the income tax title shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212; and the House recedes with an amendment defining the word 'paid' when used for the purpose of computing the deductions and credits."

In stating the deductions to be allowed from gross income, both House and Senate had used the term "paid or incurred" in some cases (Secs. 214 (a) (1) and 234 (a) (1)) and in other cases both had used the term "paid or accrued". (Secs. 214 (a) (2) and (3) and 234 (a) (2) and (3)). With respect to allowable credits, only the term "paid" had been used in both House and Senate drafts of the bill. (Secs. 222 (a) (1) and (2) and 238 (a)). The conferees added to the provisions for foreign tax credits, both as to individuals (Sec. 222) and as to corporations (Sec. 238;

see Appendix. p. 34) a paragraph with respect to treatment of accrued foreign taxes. At the same time, the conferees added the definition of the term "paid", obviously for the purpose of making the same rules apply to credits as to deductions.

Neither the House nor Senate Committee reports (House Report No. 767 and Senate Report No. 617, 65th Congress) contained any discussion of the definitions of "paid" and like terms in Section 200 or of the basis of computing income prescribed in Section 212 (b). The amendments in both sections made by the Senate Finance Committee were agreed to by the Senate without debate (Congressional Record, 65th Congress, 3rd Session, pages 296 and 553).

Thus, the change from the requirement of the cash basis for all returns (with an option to corporations to make returns upon the basis upon which its accounts were kept) to the requirement that all returns must be upon the basis and in accordance with the method of accounting regularly employed, was accomplished without comment in the Committee reports, and so far as we can discover, without mention in the debates on the bill. The statutory history gives no reason for ascribing to Congress any intention other than that which the phraseology implies, namely, that the books of account, kept in accordance with an accounting method regularly employed, should be the controlling test in determining whether deductions or credits should be taken at the time of accrual or at the time of payment. Congress at all times, in the 1918 and prior Revenue Acts, deliberately refrained from prescribing any method of accounting but allowed taxpayers full freedom in devising their own books and forms and in adapting their own methods of account-

ing to the particular needs of their respective business organizations. It seems clear that it was the intent of Congress to make the books of account, as kept in accordance with a method of accounting regularly employed, the basis for return of income rather than any arbitrary basis which would necessitate numerous, and often complex, adjustments between the books of account and the return.

C. Review of Cases Construing These Statutory Provisions.

These provisions of the 1916 and 1918 Acts have been before the Court in several cases. It has been decided that the statute requires the deduction or credit to be taken in the year of accrual when the method of accounting is on an accrual basis and the book entries in question are made as accruals or should be so made under the method of accounting regularly employed. *United States v. Anderson,* and *United States vs. Yale & Towne Company,* 269 U. S. 422, reversing *Anderson v. United States,* 60 Ct. Cls. 106, and *Yale & Towne v. United States,* 60 Ct. Cls. 440; *American National Company vs. United States,* 274 U. S. 99.

It has been decided that the statute requires the deduction or credit to be taken in the year of payment when the method of accounting is on a cash receipts and disbursements basis and the book entries in question are made as cash transactions or should be so made under the method of accounting regularly employed. *United States v. Mitchell,* 271 U. S. 9, reversing *Mitchell vs. United States,* 60 Ct. Cls. 451.

When the method of accounting is on a mixed accrual and cash disbursements basis, containing groups of accounts on the cash basis but a majority of the ac-

counts on an accrual basis, and when the book entries in question are and should be on the cash basis under the method of accounting regularly employed, it has not been decided whether the deductions and credits should be taken in the year of payment in accordance with the basis of the particular accounts to which the expenditure belongs under the method of accounting regularly employed, or in the year of accrual in accordance with the basis of the majority of the accounts but contrary to the basis prescribed by the method of accounting regularly employed. That question is presented in this case.

We emphasize that in this case the British tax payments were not isolated items in a set of accounts on the accrual basis but were a part of the London Office expense accounts, all of which were on a cash disbursements basis under the method of accounting regularly employed by the petitioner (R. 29, findings IX and X).

This Court in deciding cases of this character has laid much emphasis upon the method of accounting employed by the taxpayer, and in all of its decisions has held the particular method of accounting actually employed to be controlling in determining whether deductions shall be taken when paid or when accrued.

In *United States vs. Anderson and United States vs. Yale & Towne Company,* 269 U. S. 422, which dealt with the deduction of munitions taxes in making a return under the Revenue Acts of 1916 and 1917, the decision was based upon the method of accounting regularly employed by the taxpayers. In both cases it appeared that the munitions taxes in question had been accrued on the books of the taxpayers in 1916 in accordance with the method of accounting regularly employed. In the *Anderson case* a reversing entry was

made at the close of the year, closing out the reserve for munitions taxes accrued (269 U. S. 422, 442, 443), but it was clear that the method of accounting regularly employed required the accrual of such items and therefore the reversing entry was disregarded. In the opinion, the Court said:

> "It should be noted that Sec. 13(d) makes no use of the words 'accrue' or 'accrual' *but merely provides for a return upon the basis upon which the taxpayer's accounts are kept,* if it reflects income—which is precisely the return insisted upon by the Government. We do not think that the Treasury decision contemplated a return on any other basis when it used the terms 'accrued' and 'accrual' and provided for the deduction by the taxpayer of items 'accrued on their books.' " (269 U. S. 422, 441, italics ours.)

In *American National Company* vs. *United States,* 274 U. S. 99, the particular method of accounting regularly employed by the taxpayer was held controlling and the return made in accordance with the actual book entries under that method was upheld against the Government's contention that the accruals shown on the books had not in fact accrued and that the method of accounting employed did not correctly reflect income.

A similar question under the Revenue Act of 1916 was presented in *Reinecke* vs. *Gardiner,* 277 U. S. 239, on certificate from the Circuit Court of Appeals of the Seventh Circuit, but the Court declined to pass on the question because the certificate failed to show the basis upon which the return was made. The Court said:

> "We are unable to answer the question for the reason that the certificate omits to state facts essential to its determination. The applicable section, 13(d) of the Act of 1916, directs that if the taxpayer keeps his books on any basis other than that of actual receipts and disbursements, and the return is made on the basis adopted, the tax shall be computed on that basis unless the books clearly do not reflect the taxpayer's true income. In *United States* vs. *Anderson*, 269 U. S. 422, it was pointed out that under the Act of 1916 and applicable treasury regulations, the taxpayer must make all deductions from gross income as of the year when the payments were made unless he keeps his books on an accrual basis which accurately reflects his income, and actually made his return on that basis. See *United States* vs. *Mitchell*, 271 U. S. 9; *American National Co.* v. *United States*, 274 U. S. 99. The present certificate fails to state whether the books of the trustee as kept reflected his income or whether his return was made on the accrual basis or on the basis of actual receipts and disbursements." (277 U. S. 239, 244-245.)

In *United States* vs. *Mitchell*, 271 U. S. 9, arising under the Revenue Act of 1918, it was held that when the method of accounting was on a cash basis, an estate tax was deductible from income in the year when paid and not in the year when accrued. The Court there said:

> "The return shows that it was made on the basis of income actually received in 1919. This indicates that the accounts were kept on the basis of actual receipts and disbursements, and there is nothing in the record to show that any other method was employed. The burden is on the executors to establish the invalidity of the tax. *United States v. Anderson, supra.* They have

not shown that their books were kept on the accrual basis. Assuming, as we must, that the accounts of the estate were kept on the basis of actual receipts and disbursements, the executors were required to make return on that basis." (271 U. S. 9, 12.)

The Court again considered the same question in denying certiorari in *Fourth & Central Trust Company, Executor* vs. *United States,* 278 U. S. 604. It there appeared that the taxpayer's books did not disclose any accrual of the estate tax or any entry until paid in the year after accrual and it was accordingly held that the deduction must be taken when paid and not when accrued. (*Fourth & Central Trust Company, Executor* vs. *United States,* 65 Ct. Cls. 96, 98-99, 100.)

D. The Statute Has Been Erroneously Construed and Applied by the Lower Court.

The Court of Claims applied the above quoted provisions of the statute to this case as follows:

"The right to recover depends in this instance upon whether the plaintiff kept its books on an accrual or cash basis. An examination of its books and its system of accounts by the Commissioner of Internal Revenue satisfied that official that they were kept on an accrual basis within the meaning of the statute, and he so ruled. It is admitted that no system of bookkeeping will probably be found which is on a 100% accrual basis. In almost every case where books are kept on an accrual basis, as a general principle of business, there are instances where certain accounts, small and sometimes covering a small percentage, are kept on a cash basis. We there-

fore concur in the ruling of the Commissioner that the books were kept on an accrual basis.

"The Court has found that while it appears that some of the accounts of the plaintiff were kept upon a cash basis *and the British account among them*, it does not clearly appear what proportion was kept on the accrual basis, or that the greater proportion of its business was not kept upon the accrual basis * * *.

"* * * Where only a relatively small part has been on the cash basis it must be held that the income should have been returned upon an accrual basis." (Italics ours.) (R. 38-39.)

We submit the Court of Claims erred in this construction of the statute.

1. The lower court's construction ignores the phraseology of the statute.

The statute makes the test "the method of accounting regularly employed in keeping the books of such taxpayer." The terms are simple and plain. Only one qualification appears in that section and that is that the method employed must clearly reflect income, which qualification we shall later discuss. Otherwise the taxpayer's method of accounting governs and the statute does not authorize the application of any other test or rule for determining whether an expenditure shall enter into the return of income at the time of accrual or not until the time of payment.

The statute does not require that income shall be returned upon a cash basis or upon an accrual basis or upon the basis upon which the majority of the accounts may be kept. The statute uses neither the term "cash" nor the term "accrual." It requires only that the return of income shall be in accordance

with the method of accounting regularly employed in keeping the books of such taxpayer. The language of the statute plainly negatives the construction placed thereon by the Court of Claims.

The Court of Claims does not cite or quote the particular language of the statute upon which its conclusion is based. The Court held in effect that books must be kept and income returned upon either a strict cash basis or upon a strict accrual basis. But neither of these terms is used in the statute and nowhere is there any definition of or limitation upon the method of accounting which may be used by a taxpayer, other than the qualification above referred to, that it must clearly reflect income.

The lower court in its opinion also stated that the books of petitioner were kept on an accrual basis "within the meaning of the statute." It mistakenly assumed the presence in the statute of the term "accrual" or of some definition of the accrual basis of accounting. Neither such a term nor such a definition are found anywhere in the statute.

The opinion of the Court of Claims also shows that it considered as material the basis upon which the majority of the accounts were kept or upon which the greater proportion of the business was entered on the books. The Court evidently was of the opinion that in a mixed accounting method, partly accrual and partly cash disbursements basis, the test should be the basis of a majority of the accounts or the basis of the accounts containing the greater proportion of the business transacted. The language of the statute contains no warrant whatever for any such test.

It seems obvious that the lower court has overlooked and failed to give effect to the phraseology of the statute. It found that the British taxes were

entered on the petitioner's books of account at the time of payment in 1918 "in accordance with the method of accounting regularly employed in keeping plaintiff's books." This finding is almost in the language of the statute and shows conclusively that the particular entry of British taxes in 1918 fully met the requirements of the statute to make the entry properly allocable to that year in the return of income for tax purposes. The subsequent finding that other accounts were kept on the accrual basis and that the principal and dominant purpose and plan of the accounts were to show income upon an accrual basis as a general and controlling character of the accounts, cannot affect the answer to the question here presented. The test prescribed by the statute is the method of accounting regularly employed. That must necessarily mean the basis of the particular account to which the entry in question belongs under the method of accounting regularly employed and not the basis of some other account or of the majority of the accounts. The findings of fact unqualifiedly show that the British taxes were expenses of petitioner's London office; that under the method of accounting regularly employed, expenses of the London office were on a cash basis; and that the British taxes in question were entered in 1918 on the cash basis in accordance with the method of accounting regularly employed. On these facts, the statute requires that the British taxes enter into the accounts for tax purposes at the time of payment and not at any other time.

2. The lower court's construction conflicts with contemporaneous departmental construction.

The language of the statute obviously contemplated a variety of accounting methods differing with the special requirements of each taxpayer. The regulations of the Treasury Department ever since those first promulgated under the Revenue Act of 1918 consistently so recognized. Neither the statute nor the regulations undertook to prescribe any particular method of accounting to the exclusion of all other methods. Neither attempted to limit taxpayers to a choice of alternative methods, either a strict cash basis or a strict accrual basis.

Regulations No. 45, as first promulgated under the 1918 Act, contained as part of Article 24 the following opening sentence, under the heading "Methods of Accounting":

> "It is recognized that no uniform method of accounting can be prescribed for all taxpayers and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose."

Exactly the same sentence is contained in the regulations issued under all subsequent Revenue Acts. (Acts of 1921, 1924, 1926 and 1928; Art. 24 of Regs. 62, 65 and 69 and Art. 323 of Regs. 74.)

This contemporaneous departmental construction, announced soon after the enactment of the Revenue Act of 1918 and consistently adhered to in the construction of similar provisions of all subsequent Revenue Acts, constitutes convincing proof of the error of the interpretation placed upon the statute by the Court of Claims in its decision of this case. *United States v. Hermanos*, 209 U. S. 337; *United States v. Boston & Maine R. R.*, 279 U. S. 732, 734-736.

The enactment of the same provisions in subsequent Revenue Acts after they had been so construed by administrative regulations, confirmed that construction as being in accordance with the intent of Congress. *National Lead Co. v. United States*, 252 U. S. 140.

3. The lower court's construction conflicts with principles announced in decisions of this court.

In all of the decisions of this Court dealing with the question of when deductions or credits shall be taken, the accounting method actually employed by the taxpayer has been held controlling in determining whether deductions or credits shall be taken when paid or when accrued. None of these cases are authority for the proposition stated herein by the Court of Claims that the basis of the majority of the accounts must govern and the basis actually employed in accordance with the regular accounting method must be ignored. Such a proposition is distinctly negatived by the opinions of this Court in the cases heretofore discussed (supra, p. 13) and by the fact that this Court has uniformly adopted as the test, the method of accounting actually employed in keeping the taxpayer's books.

In this case the findings of fact show that the entries in the accounts were made when paid in the year 1918 and that the entries so made were in accordance with the method of accounting regularly employed by the petitioner. On those facts, the principles announced by the decisions cited require that the petitioner's method of accounting govern and that the credits be taken in the year when paid, regardless of the time of accrual.

E. The Lower Court's Decision Cannot be Supported on Ground that Petitioner's Method of Accounting did not Clearly Reflect Income.

As has been shown, the rule contained in the statute is that the method of accounting regularly employed governs in determining whether deductions or credits shall be taken in the year of payment or in the year of accrual. That method of accounting cannot be ignored or modified except upon one condition, namely, that such method of accounting does not clearly reflect the income, in which event the Commissioner is authorized to make the computation upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income.

That condition has no application in this case. The Court of Claims did not rest its decision upon that provision of the statute and at no time in the progress of this case, either before the Bureau of Internal Revenue or before the Court of Claims, was there ever any contention that the petitioner's method of accounting did not clearly reflect income. Furthermore, this is a question of credit of foreign income taxes against domestic taxes and not a deduction of an expense from gross income and therefore the question of clearly reflecting income does not arise in this case.

The Government's brief in opposition to petition for certiorari suggests, for the first time since this suit was begun, that the Commissioner's disallowance of the credit claimed was an implied finding that the method of accounting employed by petitioner did not clearly reflect income. We think it is too late to raise that point for the first time in this Court.

If the point may be considered, it is plainly without merit.

In the first place, an implication or inference certainly should not be sufficient to condemn a method of accounting regularly employed by a taxpayer. To set aside such method surely must require a direct and unmistakable finding that the method employed does not clearly reflect income. A finding that one single item of many should be changed certainly does not constitute a finding or even a suggestion that the method of accounting employed is improper as a method. The controversy here arose in the first instance because of the Commissioner's erroneous views as to his powers to adjust accounts on a taxpayer's books, views that were carried over from the administration of T. D. 2433 under the 1916 Act. His finding with respect to the British tax credit here in question therefore did not constitute even an implication or an inference that the method of accounting employed did not clearly reflect income.

Secondly, if the method employed does not clearly reflect income, the Commissioner is authorized to prescribe the basis and manner of the computation of income. This necessitates the adjustment of all accounts and entries to the basis which may be prescribed by the Commissioner. If the Commissioner prescribes a basis differing from the method employed he should be required to apply that basis consistently, and should not be permitted to make only isolated changes here and there with the sole object of increasing the tax. At least the taxpayer is entitled to notice of the basis which the Commissioner prescribes and opportunity to propose adjustments which will bring its accounts to the basis so prescribed. The object should be to so readjust the accounts as to clearly reflect income on the basis prescribed by the Commissioner. Here all of the London office expenses were on a cash basis.

The item of British taxes was but one of many London office expenses, which also included rent, salaries, commissions, property taxes, exchange, postage, and all other expenses of operating the London selling office. Had petitioner's method of accounting been rejected as not clearly reflecting income, numerous other adjustments would have been necessary in petitioner's London office accounts. Such adjustments were not made nor were they ever proposed by the Commissioner of Internal Revenue or by any other Government officer, nor was any opportunity ever given the taxpayer to make such adjustments.

Furthermore, the record clearly shows that the method of handling the British taxes, as a method, was accepted by the Commissioner of Internal Revenue for all other years (R. 29). For the year 1919, the year subsequent to that here involved, the British income tax was again paid, this payment being tax for the year following the year covered by the payments made in 1918. The payment made in 1919 was claimed as a credit in that year and was allowed as such credit (R. 29). The next year's British income tax, namely, for the year ending April 5, 1920, was not paid until 1924, due to numerous delays in the audit and final adjustment of the accounts with the British tax authorities. Had that tax been accrued in the manner in which the Government contends the tax payments of 1918 should have been accrued, it would have been allowable as a credit against the taxes for 1919. However, it was not so allowed. It remained in petitioner's accounts for 1924 and the only reason it was not claimed or allowed as a credit in that year was the fact that petitioner's return for 1924 showed a net loss and, therefore, there was not any tax due against which credit could be claimed. (R. 29.)

All payments of British taxes, other than the two payments made in 1918, were accepted and allowed by the Government as they appeared in petitioner's accounts and in accordance with the method of accounting employed by petitioner. Thus it is clear that the method of accounting, as a method of handling the British taxes, was affirmatively approved by the Commissioner for all years subsequent to the year 1918. If there was anything wrong with the method, as a method, it would have been necessary to change it and make adjustments in all years and not in one year only. The method cannot be wrong in 1918 and right in all other years. The Commissioner's approval of the method in subsequent years and the failure to make any express finding that petitioner's method of accounting employed in 1918 failed to clearly reflect income, show conclusively that the method was a proper one, that it did clearly reflect income and that there is no merit in the suggestion now made that the Commissioner's act should be sustained on the ground that the method of accounting employed by petitioner did not clearly reflect income.

It is not our position that an entry in the books of account is controlling if that entry is contrary to the accounting system and not the kind of entry that the method of accounting regularly employed requires. But if the entry is in accordance with the method of accounting regularly employed, and in this case the findings of fact so show (R. 29), the statute requires that the actual entry must be given effect and the deduction or credit of that item must be determined in accordance with the entry.

The situation here presented is not that of an isolated entry on a cash basis in an accounting system on a strict accrual basis. Here a separate and distinct

group of accounts, those pertaining to the London office of petitioner, were regularly on a cash basis. The principal accounts in the United States were on an accrual basis; some of the minor domestic accounts were also on a cash basis.

It cannot be said that such a method of accounting fails to clearly reflect income. Petitioner had a definite and well formulated method of accounting devised to meet the requirements of its business.

The cash basis was adopted for the London office expenses for reasons of convenience and necessity. The evidence in the lower court went into great detail in describing the method of accounting employed in the London office, and the system of vouchers of cash disbursements periodically transmitted from the London office to the main office in New York. The original book records and vouchers containing all entries of 1918 pertaining to the London office accounts were before the court. From that evidence the lower court made the finding that the accounting of expenses of the London office was on a cash disbursements basis and that the British tax payments in question were expenses of the London office and were entered in 1918 in accordance with the method of accounting regularly employed (R. 29).

Mixed accounting systems such as that of petitioner are in common use by corporations and other business organizations. As stated in the lower court's opinion:

> "It is admitted that no system of bookkeeping will probably be found which is on a 100 per cent accrual basis. In almost every case where books are kept on an accrual basis, as a general principle of business, there are instances where certain

accounts, small and some times covering a small percentage, are kept on a cash basis."

It is equally true that frequently certain groups of accounts, which must be kept in part away from the main accounting office, are kept on a cash basis while the main accounts are on an accrual basis. In petitioner's case it would have given rise to many complications and considerable expense if accrual accounts had been kept for the London office and other foreign selling offices. It would have been necessary to have at each office bookkeeping departments and the complications of foreign exchange would have made the handling of accruals difficult and burdensome. Elaborate accounting systems for distant foreign offices, which were only selling offices, were wholly unnecessary and would have resulted in making the accounting a burden to the business rather than an aid to it. These and other reasons caused petitioner to adopt the accounting system which it regularly employed in the handling of foreign office expenses.

It cannot be charged that the entry of British tax payments at the time of payment was prompted by the desire to have them allowed as a credit against taxes for the year 1918. These payments were made and entered on the books in January, 1918, and the Revenue Act, which for the first time allowed as a credit payments of foreign taxes and which for the first time adopted the test of the method of accounting as the test for determining whether items should enter into the tax returns in the period of accrual or the period of payment, was not enacted until February 24, 1919, more than one year after these payments had been made and entered on the books. The bill had not even been drafted when the British tax payments were made

and entered on the books. It cannot therefore be suggested that petitioner's method of accounting was devised or modified to meet the provisions of this statute.

F. Conclusion.

The correct construction of the statute is that the terms "paid or incurred" and "paid or accrued," wherever used in the Act, mean *paid* for all items which under the taxpayer's method of accounting are regularly entered on the cash disbursements basis; that they mean *incurred* or *accrued* for all items which, under the taxpayer's method of accounting, are regularly entered on the accrual basis. Entries in the books of account made in accordance with the method of accounting regularly employed must govern, so long as it is not found that the accounts thus kept do not reflect accurately the income. Applying the rule to this case, the term "paid" in section 238 (a) of the Revenue Act of 1918 means "paid" and not "accrued" in relation to the British taxes here in question, for those British tax payments were entered on petitioner's books on the cash disbursements basis in accordance with the method of accounting regularly employed. The foreign tax payments, paid in 1918, are therefore allowable as a credit for that year.

It is therefore respectfully submitted that the judgment of the lower court on the point here presented, namely the allowance of credit under section 238 (a) of the Revenue Act of 1918, against the income and profits taxes of petitioner for the year 1918, should be reversed and the cause remanded to the end that

judgment may be awarded petitioner for refund of taxes due it upon the allowance of such credit.

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Washington, D. C.
December 30, 1929.

APPENDIX.

Section 13 (d) of the Revenue Act of 1916.

(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

T. D. 2433.
Corporation Income Tax.

Corporations keeping books in accordance with standard systems of accounting or in conformity with the requirements of some Federal, State, or municipal authority having supervision over such corporations, may make their returns on the basis on which their books are kept, provided the books so kept and the returns so made reflect the true net income of the corporations for each year.

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington, D. C., January 8, 1917.

To collectors of internal revenue:

Subparagraph (d) of section 13 of Title I of the Act of September 8, 1916, provides that—

A corporation, joint stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval

of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods amounts sufficient to meet fixed annual or other charges to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

In cases wherein, pursuant to the consistent practice of accounting of the corporation, or pursuant to the requirements of some Federal, State, or municipal supervising authority, corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which is not definitely determined or determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined the actual amounts which experience has demonstrated would be necessary to discharge the liabilities incurred during the year and for the payment of which additions to the reserves were made; and provided, if it shall be found that the amount credited to any such reserve is in excess of the rea-

sonable or probable needs of the corporation to meet and discharge the liabilities for which the reserve is credited, the excess of such reserve over and above the reasonable or probable needs for the purpose indicated shall be at once disallowed as a deduction and restored to income for the purpose of the tax; and provided further, that in no event will sinking funds or other reserves set up to meet additions, betterments, or other capital obligations constitute allowable deductions from gross income.

This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis and that the same practice shall be consistently followed year after year. Amounts paid in discharge of any liability or obligation for which a reserve has been set up, as hereinbefore outlined, will, when paid, be charged to the reserve created to meet it in so far as such reserve is sufficient to meet the liability, provided always that the liability is of a character which constitutes an allowable deduction within the meaning of the law.

If upon investigation it shall be found that returns made upon the basis of accruals and reserves do not reflect the true net income, the corporation so failing in this way to return the true net income will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements.

The reserves contemplated by the foregoing ruling are those reserves only which are set up to meet some actual liability incurred, the amount necessary to discharge which can not at the time be definitely determined, and do not contemplate reserves to meet losses contingent upon shrinkage in values, losses from bad

debts, capital investments, etc., which losses are deductible only when definitely determined as the result of a closed or completed transaction and are charged off.

W. H. OSBORN,
Commissioner of Internal Revenue.

Approved:
W. G. MCADOO,
Secretary of the Treasury.

Sections of Revenue Act of 1918 as Agreed to in Conference Showing Amendments of Senate and of Conferees.

(Parts in Roman type indicate provisions of House Bill unchanged. Roman type struck through indicate parts stricken by Senate and omitted by conferees. Italics indicate additions by Senate and agreed to by conferees. Capitals indicate added by conferees.)

Section 200.

THE TERM "PAID," FOR THE PURPOSES OF THE DEDUCTIONS AND CREDITS UNDER THIS TITLE, MEANS "PAID OR ACCRUED" OR "PAID OR INCURRED," AND *the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis on which the net income is computed under Section 212.*

Section 212 (b).

"(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in

accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if ~~it~~ *the method employed* does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. . . ."

Section 238.

"CREDIT FOR FOREIGN TAXES.

(a) That in the case of a domestic corporation the total ~~income war profits and excess profits~~ taxes imposed for the taxable year ~~by Act of Congress~~ *by this Title and by Title III* shall be credited with the amount of any income, war profits and excess profits taxes paid during the taxable year to any foreign country ~~Porto Rico or the Philippine Islands~~ upon income derived from sources therein *or to any possession of the United States.*

IF ACCRUED TAXES WHEN PAID DIFFER FROM THE AMOUNTS CLAIMED AS CREDITS BY THE CORPORATION, OR IF ANY TAX PAID IS REFUNDED IN WHOLE OR IN PART, THE CORPORATION SHALL AT ONCE NOTIFY THE COMMISSIONER WHO SHALL REDETERMINE THE AMOUNT OF THE TAXES DUE UNDER THIS TITLE AND UNDER TITLE III FOR THE YEAR OR YEARS AFFECTED, AND THE AMOUNT OF TAXES DUE UPON SUCH REDETERMINATION, IF ANY, SHALL BE PAID BY THE CORPORATION UPON NOTICE AND DEMAND BY THE COLLECTOR, OR THE AMOUNT OF TAXES OVERPAID, IF ANY, SHALL BE CRED-

ITED OR REFUNDED TO THE CORPORATION IN ACCORDANCE WITH THE PROVISIONS OF SECTION 252. IN THE CASE OF SUCH A TAX ACCRUED BUT NOT PAID, THE COMMISSIONER AS A CONDITION PRECEDENT TO THE ALLOWANCE OF THIS CREDIT MAY REQUIRE THE CORPORATION TO GIVE A BOND WITH SURETIES SATISFACTORY TO AND TO BE APPROVED BY HIM IN SUCH PENAL SUM AS HE MAY REQUIRE, CONDITIONED FOR THE PAYMENT BY THE TAXPAYER OF ANY AMOUNT OF TAXES FOUND DUE UPON ANY SUCH REDETERMINATION; AND THE BOND HEREIN PRESCRIBED SHALL CONTAIN SUCH FURTHER CONDITIONS AS THE COMMISSIONER MAY REQUIRE.

(B) This credit shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income ~~received~~ *derived* from sources within such foreign ~~country, Porto Rico, or the Philippine Islands~~ *country or such possession of the United States*, as the case may be, and all other information necessary for the computation of such credit."

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MAR 7 19
CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

No. 314.

NILES BEMENT POND COMPANY, *Petitioner*,
vs.
THE UNITED STATES, *Respondent*.

REPLY BRIEF OF PETITIONER.

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March 6, 1930.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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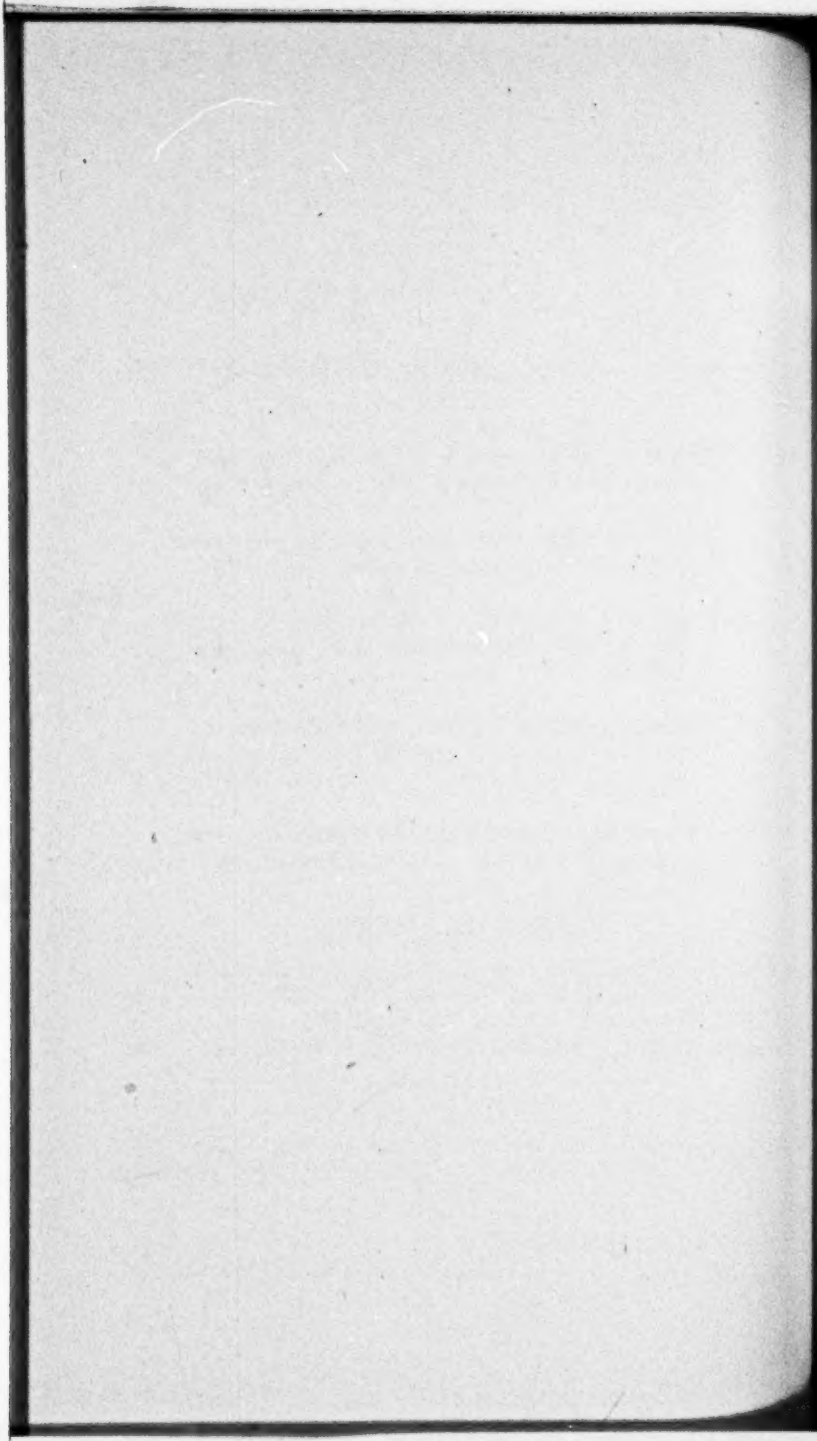

IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

No. 314.

NILES BEMENT POND COMPANY, *Petitioner,*
vs.
THE UNITED STATES, *Respondent.*

REPLY BRIEF OF PETITIONER.

I.

(a) The Government errs in confusing the provisions of the 1916 and 1918 Revenue Acts.

The Government's brief quotes portions of the 1916 Revenue Act (Sections 12 (a), 13 (d)) which act we think is not here involved except as a matter of historical interest in the evolution of the 1918 Revenue Act. The latter act must govern in the determination of this case. From the 1918 act, the Government's brief quotes (page 10) a provision of section 200 defining the

terms "paid" and "accrued," which definition refers to section 212, but the Government's brief at this point does not refer to section 212 (b) which provides that the method of accounting referred to in section 200 is the method of accounting regularly employed by the taxpayer in keeping its books. Having made this omission, the Government proceeds to argue that the basis on which *the return was filed* rather than the basis on which *the books were kept,* is the test to be applied in deciding this case.

Pursuing this argument (pages 10-11), the Government argues that the only applicable finding is that to the effect that the returns were filed on an accrual basis. We think the Government has confused the requirements of the 1916 Act with those of the 1918 Act. Under the 1916 Act, the basis on which a taxpayer filed its return determined whether or not the taxpayer had elected the option under Section 13 (d) to make a return upon other than a cash basis. However, under the 1918 Act, the basis of the return is immaterial. There is no option for the taxpayer to elect. Regardless of how he may purport to make out his return, the statute requires that the income shall be computed in accordance with the method of accounting regularly employed in keeping the taxpayer's books of account.

(*b*) *Petitioner regularly employed a mixed cash and accrual method of accounting.*

The findings must be read together. So read, the fact is clear that the petitioner's books were on a mixed cash and accrual basis. The lower court's conclusion that the books were kept on an accrual basis is shown by the opinion to rest on its view that the statute required either a cash or an accrual basis and permitted

no intermediate ground. The lower court thus concluded that the petitioner's books and returns were on an accrual basis because the majority of its accounts were kept on an accrual basis. This was a conclusion of law and not a finding of fact. The findings clearly show the existence of a mixed cash and accrual method of accounting regularly employed by petitioner. The application of the statute to such a state of facts is the question of law here presented.

(c) *Petitioner's method of accounting for its British tax payments was at all times consistent.*

The Government also argues that the same methods of accounting must be applied to both sides of the account. That is unquestionably true when dealing with a given account. However, in this case we have a distinct group of accounts, applicable to the London Office, which of necessity were handled at that office. In those accounts the cash basis was consistently used; the accounts in which the accrual basis was used were entirely separate and distinct, were kept wholly in the United States and did not relate to the London office.

The situation here presented is not that of an isolated entry on one basis in an accounting system, all the balance of which is on another basis. That was the kind of an entry that the Court referred to in *United States vs. Mitchell*, 271 U. S. 9, 12-13, in the statement quoted at page 12 of the Government's brief.

The exigencies of business frequently require that certain groups of accounts be kept on a basis differing from that of the principal accounts. In this case, the foreign office accounts were kept on a cash basis in

order to avoid complicated accounting systems in distant foreign offices and in order to avoid complications of foreign exchange which would be exceedingly burdensome in accrual systems dealing with different and fluctuating foreign currencies. Petitioner has consistently treated the London Office accounts on a cash basis. It always has done so and of necessity always will do so.

(*d*) *Commissioner of Internal Revenue made no finding that petitioner's method of accounting did not clearly reflect income.*

The Government's brief does not charge that the Commissioner of Internal Revenue made a finding that petitioner's method of accounting did not clearly reflect income. We suppose that the Government recognizes here what it vigorously argued in *United States v. American Can Company* (No. 128 this Term, decided February 24, 1930), and what we understand the Court there held, that the mere correction of an alleged error does not constitute a rejection of the method of accounting employed and is not equivalent to a finding that the method of accounting employed failed to clearly reflect income.

In this connection the Government also suggests that the Record does not show the exact form of the return. This, however, is immaterial. Under the 1918 Act, the test is the method of accounting employed and the findings do show the method of accounting employed so far as it relates to the matter here in controversy. Furthermore, the findings disclose that the British tax payments were claimed as a credit on the petitioner's 1918 tax return and that this claim was disallowed. (Finding VI, Record 28.)

The suggestion (advanced for the first time in this Court) that the petitioner's method of accounting does not clearly reflect the income, has already been discussed in our original brief. (Pages 23-28.)

II.

Petitioner does not seek a determination of the question of when the British taxes accrued.

Referring to Point II of the Government's brief (pages 14-16) we have not contended that the excess profits duty accrued (in the sense in which that term was used by the Court in its decision in *United States v. Anderson*, 269 U. S. 422) in 1918. It is undoubtedly true, as suggested by the Government's brief, that the income tax paid to the British Government for the tax year beginning April 6, 1917, and ending April 5, 1918, accrued, in part at least, in the year 1918. The accrual in that calendar year would be in the proportion represented by the ratio of the part of the tax year falling in the calendar year 1918 to the total tax year. However, this point alone would involve a relatively small amount and the question, so far as we know, is not of general importance. Therefore, we have not desired to burden the Court with considering that particular point.

Respectfully submitted,

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March 6, 1930.

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CHARLES ELMORE

No. 314

In the Supreme Court of the United States

OCTOBER TERM, 1929

NILES BEMENT POND COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 27–40) is not yet officially reported.

JURISDICTION

The judgment sought to be reviewed was entered May 13, 1929. (R. 40.) The petition for writ of certiorari was filed August 9, 1929. (R. 41.) The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether petitioner was entitled, in its return for income and profits taxes for the calendar year 1918, to a credit on account of British taxes paid in that year, but assessed on account of income received in the years 1914, 1915, and 1916, where during the years 1916, 1917, 1918, and 1919 petitioner's books of account were kept on the accrual basis, and tax returns for said years were filed on the accrual basis.

STATUTES INVOLVED

The pertinent provisions of the Revenue Act of 1916, c. 463, 39 Stat. 756, 767, 769–771, are as follows:

DEDUCTIONS

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

* * * * *

Fourth. Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or any foreign country, or under the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

* * * * *

RETURNS

SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained * * *;

* * * * * *

(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

* * * * * *

STATEMENT

The amended petition upon which the case was tried in the Court of Claims asked recovery of income and excess-profits taxes paid for the years 1917, 1918, and 1919 upon three separate grounds, but the petition for writ of certiorari presents only the claim for credit on account of British taxes paid in 1918.

The Court of Claims found that the petitioner is, and has been since 1900, a New Jersey corporation with principal place of business at New York City, and that it was, during the years 1916 to 1919, engaged in the business of manufacturing machine

tools and selling such products in various States of the United States and in Great Britain and other parts of the world. (R. 27.)

Petitioner in 1918 paid to the Government of Great Britain $4,488.72, as income taxes for the year beginning April 6, 1917, and ending April 5, 1918, on income derived from sources within Great Britain, and $44,126.40 as excess-profits duty for the accounting period ended December 31, 1916, on income derived from sources within Great Britain. (R. 28.)

The amounts of said taxes were claimed as a credit on petitioner's income and profits tax return for the calendar year 1918, but the Commissioner of Internal Revenue refused petitioner credit for said taxes for that year. The British taxes were paid pursuant to notices dated January 19 and 24, 1918. These notices were the first information received by petitioner as to the amount of the aforesaid income tax and excess-profits duty. (R. 28.)

Throughout the year 1918 petitioner, in keeping its books, accounted for the expenses of the London office upon a cash-disbursement basis, and no accruals were made for any such expenses in advance of payment. The British taxes paid in 1918 were expenses of petitioner's London office. (R. 29.)

During the years 1916, 1917, 1918, and 1919, the books of petitioner were kept on the accrual basis. There were some exceptions in small items of deferred charges and credits in the petitioner's ac-

counts, where the cash basis was reflected. The general and controlling character of the accounts was to show income upon an accrual basis. (R. 29–30.)

Petitioner's American tax returns for 1916, 1917, 1918, and 1919 were filed on the accrual basis. (R. 30.)

The aforesaid British income taxes paid by petitioner in 1918 were assessed on account of income received in the years 1914, 1915, and 1916. The Commissioner of Internal Revenue allowed petitioner deductions prior to 1918 for all of the British taxes in dispute. These taxes were based upon returns to the British Government made by petitioner prior to 1918. (R. 30.)

ARGUMENT

Prior to January 1, 1918, the Internal Revenue Acts provided that foreign taxes accrued or paid should reduce gross income. The Commissioner of Internal Revenue accordingly allowed the British taxes as a deduction from gross income prior to 1918, since petitioner kept its books and made its tax return on the accrual basis, and since these taxes accrued prior to 1918. Under the Revenue Act of 1916, tax returns could be made on the accrual basis, if the books were kept on that basis.

Prior to the 1916 Revenue Act, returns were required to be made on a receipts and disbursements basis. Although Section 12 (a) of the Act of 1916

dealing with deductions provided for the deduction of "expenses paid within the year," and "losses actually sustained within the year," Section 13 (d) provided for an alternative method permitting the taxpayer, if he kept his books on an accrual basis, to make his return on that basis, deducting expenses accrued within the year and taxes accrued within the year. Since petitioner kept its books and made its tax returns on the accrual basis, it must stand consistently on that basis. The fact that a branch of petitioner in London did not keep its particular account on the accrual basis in no way affects the matter, for the court below found that the general books of account of the corporation were kept on an accrual basis.

Since petitioner made its return for 1918 on an accrual basis, an allowance of credit in that year for foreign taxes accrued in prior years would be inconsistent with any method of accounting. The decision of the Commissioner of Internal Revenue with respect to the allowance of the taxes in question is sustained by *United States* v. *Anderson*, 269 U. S. 422, and *United States* v. *Mitchell*, 271 U. S. 9.

The tax return involved in the *Mitchell case* was made on the basis of actual receipts and disbursements, but the language of the opinion states the correct rule for the pending case. This Court said, in part (p. 12):

> * * * The return shows that it was made on the basis of income actually re-

ceived in 1919. This indicates that the accounts were kept on the basis of actual receipts and disbursements, and there is nothing in the record to show that any other method was employed. The burden is on the executors to establish the invalidity of the tax. *United States* v. *Anderson, supra.* They have not shown that their books were kept on the accrual basis. Assuming, as we must, that the accounts of the estate were kept on the basis of actual receipts and disbursements, the executors were required to make return on that basis. Notwithstanding the option given taxpayers, it is the purpose of the Act to require returns that clearly reflect taxable income. That purpose will not be accomplished unless income received and deductible disbursements made are treated consistently. It was not the purpose of the Act to permit gross income actually received to be diminished by taxes or other deductible items disbursed in a later year, even if accrued in the taxable year. It is a reasonable construction of the law that the same method be applied to both sides of the account.

The word "accrue" is used in different connections. Under the accrual system of accounting, however, income is said to be accrued when it is definitely receivable, although its payment may not be due, and liabilities or expenses are said to be accrued when the events have occurred which fix liability, even though payment is not yet due.

Expenses of any kind definitely incurred in the operations for a particular year are properly accrued in the accounts for that year, although payment may not be due until the following year. Under this system the use of the word "accrued" does not signify that the item is due. On the contrary, the accrual system wholly disregards due dates. Neither is it necessary that the amount of an incurred liability be accurately ascertainable in order to "accrue" it. The British taxes in question accrued prior to 1918. *United States* v. *Anderson*, 269 U. S. 422, *supra*.

On page 11 of petitioner's brief, it is contended that the Government has not questioned that petitioner's method of accounting reflected the correct income. This contention is accurate in only a very limited sense. The necessary implication from the act of the Commissioner, denying the credit claimed, is a denial of the accuracy of petitioner's procedure in combining cash items and accrual items. For taxation purposes, resort is had to the books of account for making up the correct returns. When an item shown by the books is excluded by the Commissioner from the return, it must be because the item, in his view, at least, is not a proper item entering into the final computation of income. In other words, including it would not reflect correct income for the period in question.

Petitioner's brief quotes sentences from various reported cases as support for its contentions. In

none of these cases, however, can we find a discussion of the point in issue in the pending case. In the opinion in the case of *Morris-Poston Coal Company*, 13 B. T. A., 344, cited on page 12 of petitioner's brief, is the following language:

> * * * As observed by the court in the *Hyams Coal Co.* case, *supra:*
>
> "There is no doubt that under the Revenue Law of 1918 the accrual basis, once adopted, must be consistently adhered to by the taxpayer. The courts have recognized this consistently, and denounced any practice that would result in computing taxes attributable to a given year using the cash basis for a part and an accrual basis for the balance of the year. The law contemplates consistency in the keeping of books once a method is adopted. *N. S. Barstow and Co.* v. *Bowers, Collector*, 15 Fed. (2), 75, 78."

The regulations of the Bureau of Internal Revenue, cited on page 19 of petitioner's brief, were not in effect after the accrual method of making returns was authorized by law.

CONCLUSION

The instant case presents no question of general importance which is not governed by the principles of cases decided by this Court. It is submitted that the decisions of the Commissioner of Internal Revenue and the Court of Claims upon petitioner's claim were correct.

The petition for writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER, 1929.

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BRIEF FOR THE UNITED STATES

FILE COPY

No. 314

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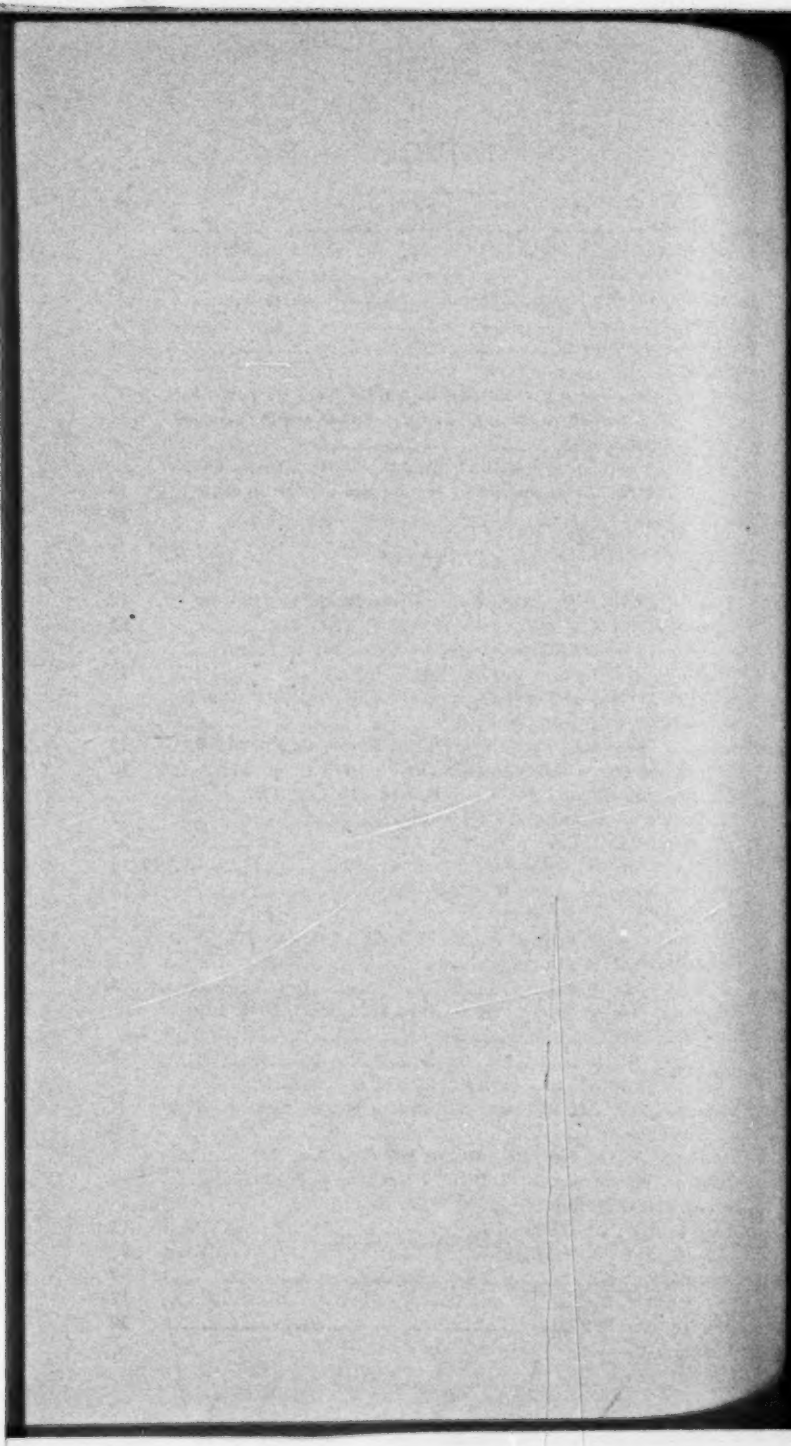

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BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 27–40) is reported in 67 C. Cls. 693.

JURISDICTION

The judgment of the Court of Claims was entered May 13, 1929. (R. 40.) Petition for writ of certiorari was filed August 9, 1929 (R. 41), and certiorari was granted October 21, 1929 (R. 43). The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Where a domestic corporation in 1916, 1917, and 1918 kept its accounts and made its tax returns on

the accrual basis, but had a London office which kept an expense account on the cash basis, was the Commissioner of Internal Revenue justified in refusing to allow the corporation to deduct from its taxes for 1918 the amount of British taxes which were paid in 1918 but accrued before 1918?

STATUTES INVOLVED

The Revenue Act of 1916, c. 463, 39 Stat. 756, 767, 769–771, provides as follows:

> SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> * * * * *
>
> Fourth. Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or any foreign country, or under the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.
>
> * * * * *
>
> SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained * * *;
>
> * * * * *
>
> (d) A corporation, joint-stock company or association, or insurance company, keeping

accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

* * * * *

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1059, 1064, 1080, provides as follows:

SEC. 238. (a) That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States.

* * * * *

SEC. 200. That when used in this title—

* * * * *

The term "paid," for the purposes of the deductions and credits under this title, means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *

STATEMENT

Petitioner sued in the Court of Claims to recover a part of the taxes for 1918 collected from it which it contends was deductible on account of British taxes paid during 1918.

In 1918 it paid the British Government the sum of $4,488.72, representing income taxes for the fiscal year beginning April 6, 1917, and ending April 5, 1918. These taxes were measured by income received from sources within Great Britain in the years 1914, 1915, and 1916, and were based on tax returns made prior to 1918.[1] In 1918 peti-

[1] This tax for the fiscal year ending April 5, 1918, has no relation to the profits actually earned in that year but is based upon "statutory income," the amount of the average profits of the three preceding years, 1914, 1915 and 1916. See Income Tax Act of June 22, 1842 (5 & 6 Vict., c. 35), Schedule (D); Finance Act of August 2, 1917 (7 & 8 Geo. 5, c. 31), Part II.

tioner also paid the British Government the sum of $44,126.40 (afterwards reduced by refund to $31,588.87) representing excess profits duty for the accounting period ended December 31, 1916, on income received from sources within Great Britain prior to that date.[2]

Various items and matters which are not involved in the question before this Court were before the Court of Claims. Of the findings of that court, the following have a bearing upon the question involved here (R. 27–30):

I

The plaintiff, Niles Bement Pond Company, is and at all times since 1900 has been, a New Jersey corporation, with its principal place of business at New York City, and was throughout said period engaged in the business of manufacturing machine tools and selling such products in the various States of the United States, and in Great Britain and other parts of the world.

II

Plaintiff seasonably filed in proper form Federal tax returns for the calendar years 1917, 1918, and 1919. Subsequent to the filing of the respective returns, the income and profits tax liability of plaintiff was determined and assessed for the year 1917 at

[2] See Finance Act of July 19, 1916 (6 & 7 Geo. 5, c. 24), Part III.

$271,505.16; for the year 1918 at $1,719,-644.93 and for the year 1919 at $323,177.92.

* * * * *

V

Plaintiff during the year 1918 paid to the Government of Great Britain the sum of $4,488.72 representing income taxes for the year beginning April 6, 1917, and ending April 5, 1918, paid on income derived from sources within Great Britain, and no part of said amount was ever refunded to plaintiff. During the year 1918 plaintiff also paid to the Government of Great Britain the sum of $44,126.40 representing excess-profits duty for the accounting period ended December 31, 1916, paid on income derived from sources within Great Britain.

VI

Said amounts of $44,126.40 and $4,488.72, totaling $48,615.12 were claimed as a credit on the plaintiff's income and profits tax return for the calendar year 1918, said credit being claimed under section 238 of the revenue act of 1918. The tax paid by plaintiff for the year 1918 was computed and determined without the allowance of said amount, or any part thereof as a credit.

VII

Subsequent to the filing of the return for 1918, plaintiff received from the Government of Great Britain a net refund of $12,537.53, reducing the payment of British excess-profits tax to a net amount of $31,588.87.

VIII

The British income tax aforesaid was paid to the British Government pursuant to a notice dated January 24, 1918. The British excess-profits duty aforesaid was paid pursuant to a "Notice of assessment and notice to pay duty," dated January 19, 1918. Said notices were the first notice, assessment, demand, or information received by plaintiff as to the amount of the income tax and excess-profits duty, respectively, so payable. The returns annually made by plaintiff to the British Government relating to income taxes and excess-profits duty contained no computation of the taxes; they contained only a report of income. Plaintiff in making its return of income did not attach any statement showing computation of the amount of the excess-profits duty payable by it for the accounting period ended December 31, 1916, or of the income tax for the year ending April 5, 1918.

IX

Under the method of accounting regularly employed by plaintiff in keeping its books throughout the year 1918, the accounting for expenses of the London office was on a cash disbursements basis and no accruals were made for any such expenses in advance of their payment.

X

The British taxes paid in 1918 were expenses of plaintiff's London office and were

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entered on the plaintiff's books of account at the time of payment in 1918 in accordance with the method of accounting regularly employed in keeping plaintiff's books.

XI

British income tax in the amount of $10,321.92 for the year beginning April 6, 1918, and ending April 5, 1919, paid by plaintiff in 1919 was claimed as a credit on plaintiff's 1919 return and was allowed as such credit under section 238 (a) of the revenue act of 1918. British income tax in the amount of $1,696.20 for the year beginning April 6, 1919, and ending April 5, 1920, was paid by plaintiff in 1924. No claim for credit was filed by plaintiff for 1920, nor was any such credit allowed; and no claim for credit was made in 1924, the plaintiff's return for that year showing a net loss and no tax due.

During the years 1916, 1917, 1918, and 1919, the books of the plaintiff were kept on the accrual basis. There were some exceptions in small items of deferred charges and credits in the plaintiff's accounts where the cash basis was reflected, but notwithstanding this the principal and dominant purpose and plan of its accounts were to show income upon an accrual basis as the general and controlling character of the accounts.

Plaintiff's corporation income-tax return for the year 1916, its corporation income-tax return and its excess profits tax return for the year 1917, and its corporation income

and profits tax returns for the years 1918 and 1919 were filed on the accrual basis.

The British income taxes paid by plaintiff in the year 1918 were assessed on account of income received in the years 1914, 1915, and 1916. The Commissioner of Internal Revenue allowed plaintiff deductions prior to 1918 for all of the British taxes in dispute. These taxes were based upon tax returns made by plaintiff prior to 1918.

The Court of Claims rendered judgment for the defendant. (R. 40.)

SUMMARY OF ARGUMENT

I. Section 238 (a) of the Revenue Act of 1918 provides that, in the case of a domestic corporation, the total taxes imposed for the taxable year shall be credited with the amount of certain foreign taxes. By virtue of the provisions of Section 200, the foreign taxes deductible are those which are paid or accrued during the taxable year "according to the method of accounting upon the basis of which the net income is computed under Section 212." The only applicable finding of the Court of Claims is that petitioner's return for the year 1918 was "filed on the accrual basis." This, with the other findings, shows that the method of accounting upon the basis of which the net income was computed under Section 212 was the accrual basis. Consequently, the petitioner was not entitled to the deduction of any foreign taxes except those which accrued in 1918.

II. The findings do not show that the British taxes which the petitioner sought to deduct did accrue in 1918, and the petitioner does not contend that any of them accrued in 1918. The $31,588.87 paid in 1918 on account of excess profits duty clearly accrued prior to 1918, and the remaining $4,488.72 paid in 1918 represented income taxes based upon tax returns made by petitioner prior to 1918.

ARGUMENT

I

PETITIONER WAS NOT ENTITLED TO DEDUCT FROM ITS TAXES FOR 1918 ANY FOREIGN TAXES EXCEPT THOSE WHICH ACCRUED DURING 1918

Petitioner's right to deduction is governed by Section 238 (a) of the Revenue Act of 1918 (p. 3, *supra*). Although this section provides that a domestic corporation shall be credited with the amount of certain taxes *paid* during the taxable year to any foreign country upon income derived from sources therein, Section 200 of the same Act (p. 3, *supra*) provides that the term "paid" as used therein—

> means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under Section 212.

The only finding applicable to the method of accounting upon the basis of which petitioner's net income was computed is that in paragraph XI, that its return for the year 1918 was "filed on the

accrual basis." (R. 30, p. 9, *supra*.) But it is true that the record does state (Finding IX, R. 29) that plaintiff's books "accounting for expenses" of its London office were kept on a cash disbursement basis and that no accruals were made thereon for any expenses in advance of their payment. It nowhere appears that, as regards income (i. e., receipts), the petitioner's books or its tax return for 1918 did not consistently use the accrual basis. Even if, in the absence of any clearer indication than appears in the findings, it can be assumed that the petitioner's return reported as expenses certain items appearing on the books of the London branch which accrued in some year other than 1918, that fact is not important.

Treasury Regulations 45 (1920 Ed.) promulgated under the Revenue Act of 1918 contained the following:

> ART. 23. *Bases of computation.*—(1) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 200 of the statute for definitions of "paid," "paid or accrued," and "paid or incurred." * * * in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. See section 213 (a) of the statute.

This provision has remained substantially unchanged in all later regulations issued by the Treasury Department. See Article 23 of Regulations 62, 65, 69, and Article 322 of Regulations 74.

As this Court said of the 1918 Revenue Act in *United States* v. *Mitchell*, 271 U. S. 9, 12–13:

> Notwithstanding the option given taxpayers, it is the purpose of the Act to require returns that clearly reflect taxable income. That purpose will not be accomplished unless income received and deductible disbursements made are treated consistently. It was not the purpose of the Act to permit gross income actually received to be diminished by taxes or other deductible items disbursed in a later year, even if accrued in the taxable year. *It is a reasonable construction of the law that the same method be applied to both sides of the account.* (Italics ours.)

See also *United States* v. *Anderson*, 269 U. S. 422; *Fourth & Central Trust Co.* v. *United States*, 65 C. Cls. 96, certiorari denied, 278 U. S. 604; *Mutual Benefit Life Ins. Co.* v. *Herold*, 198 Fed. 199, 215; *W. S. Barstow & Co.* v. *Bowers*, 15 F. (2d) 75; *Edward R. Bacon Grain Co.* v. *Reinecke*, 26 F. (2d) 705; *Robert P. Hyams Coal Co.* v. *United States*, 26 F. (2d) 805; *Henry Reubel, Exr.*, 1 B. T. A. 676.

We are aware of no case which had held that a taxpayer can apply different methods of accounting to different sides of his account in making returns of income.

The petitioner argues that his books were kept on a mixed basis and that he should have been allowed to make his returns on a mixed basis. In view of the fact that the findings show that the return as filed by the petitioner was upon the accrual basis, petitioner's contention that it was permissible for him to file a return upon a mixed basis would seem to be immaterial. But we submit that the statute does not permit the filing of a return upon which all receipts and most expenses are reported on an accrual basis, and a comparatively small part of the expenses are reported on the basis of actual disbursement. Such a return, even if it could be said to follow "the method of accounting regularly employed in keeping the books of such taxpayer" would be objectionable under the provisions of Section 212(b) because it "does not clearly reflect the income." Petitioner objects to the consideration of this matter on the ground that it does not appear that the Commissioner on that ground refused to allow the deduction, but we submit that this is immaterial. Moreover, the record does not disclose the exact form of return and does not disclose whether the Commissioner corrected the return or not. The burden is on the petitioner to prove all matters upon which it relies, and it can not predicate any argument upon anything which does not appear in the record. Cf. *United States* v. *Anderson,* 269 U. S. 422, 443; *United States* v. *Mitchell,* 271 U. S. 9, 12; *Reinecke* v. *Gardner,* 277 U. S. 239, 245.

Petitioner's contention that the Commissioner has been inconsistent in the matter of allowing deductions for its British taxes is equally futile. Finding XI (R. 29, p. 8, *supra*) does indicate that in 1919 a deduction was allowed on account of a British tax paid in that year. But the finding does not show enough facts in regard to that tax to indicate whether the Commissioner's action was correct or not. Moreover, even if it was incorrect, that would be immaterial. Petitioner has nowhere contended that the British tax paid in 1919 should have been allowed as a deduction for his taxes due the United States for 1918. It may well be that, through oversight or lack of information, the Commissioner erred in allowing the deduction of that tax in one year instead of in the other, but this is unimportant in view of the petitioner's failure to present a proper claim in regard to the matter. The record does show that the Commissioner allowed all British taxes which were paid in 1918 as deductions in computing the income returned in the years prior to 1918. This was the correct treatment of these items, and they are the only items which are before the Court.

II

THE FINDINGS DO NOT SHOW THAT THE BRITISH TAXES WHICH THE PETITIONER SOUGHT TO DEDUCT DID ACCRUE IN 1918

Petitioner seems nowhere to contend that any of the British taxes which were paid in 1918 accrued in that year. Certainly, the findings do not estab-

lish the fact that any of them did accrue in 1918, and the burden was upon the petitioner to prove this fact.

The findings show clearly that the $31,588.87 paid in 1918 on account of the excess profits duty accrued prior to 1918, as it is stated in Finding V (R. 28, p. 6, *supra*) that the excess profits duties paid were for the accounting period ended December 31, 1916. (See also Finding VII, R. 28, p. 6, *supra*.) The findings also show that this tax was based upon returns made by the petitioner prior to 1918. (Finding XI, R. 30, p. 9, *supra*.) The fact that the tax was not payable until 1918 did not prevent it from accruing prior to that time. *United States* v. *Anderson*, 269 U. S. 422, *supra*.

The situation is not quite so clear in regard to the balance of the amount sought to be deducted, $4,488.72. Finding V (R. 28, p. 6, *supra*) states that this amount represented "income taxes for the year beginning April 6, 1917, and ending April 5, 1918," but Finding XI (R. 30, p. 9, *supra*) states this was "assessed on account of income received in the years 1914, 1915, and 1916." It appears that the notice of the assessment of this was dated January 24, 1918 (Finding VIII, R. 28, p. 7, *supra*), and that it was based upon a tax return made by the petitioner prior to 1918 (Finding XI, R. 30, p. 9, *supra*).

The Government does not wish to be understood as asserting that this tax of $4,488.72 did accrue

prior to 1918. Whether it did or not depends upon questions of English law upon which we express no opinion. It seems sufficient for purposes of the present case that the findings do not state facts sufficient to show that the tax accrued in 1918. See *Cuba Railroad Co.* v. *Crosby*, 222 U. S. 473; *Coghlan* v. *South Carolina Railroad Co.*, 142 U. S. 101, 114; *Liverpool Steam Co.* v. *Phenix Insurance Co.*, 129 U. S. 397, 445.

CONCLUSION

It is respectfully submitted that the decision of the court below is correct and that its judgment should be affirmed.

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MARCH, 1930.

U. S. GOVERNMENT PRINTING OFFICE: 1930

SUPREME COURT OF THE UNITED STATES.

No. 314.—October Term, 1929.

Niles Bement Pond Company, Petitioner, *vs.* The United States. } On Writ of Certiorari to the Court of Claims.

[April 14, 1930.]

Mr. Justice Stone delivered the opinion of the Court.

This case is here on certiorari, granted October 21, 1929, to review a judgment of the Court of Claims denying recovery of a part of petitioner's income and excess profits taxes for the year 1918, alleged to have been illegally exacted. 67 Court of Claims 39. Petitioner is a New Jersey corporation having an office and principal place of business in New York. It maintains a London branch, through which it paid the British government in 1918 income tax for the fiscal year April 6, 1917 to April 5, 1918, upon income received from sources in Great Britain in 1916 and earlier years, and based on a tax return made prior to 1918. Similarly, it paid in 1918 a tax for the year ending December 31, 1916, upon income and excess profits from sources within Great Britain. In making its tax return for the year 1918 petitioner claimed credit for these payments on its tax. The Commissioner of Internal Revenue refused to allow the credit, and collected a correspondingly increased tax, which is the subject of the present suit.

The applicable provision of § 238 of the Revenue Law of 1918, c. 18, 40 Stat. 1057, provides that the tax imposed by the act on domestic corporations for any taxable year shall be credited with the amount of the income and excess profits taxes "paid" to foreign countries during that year. But § 200 defines the term "paid" in § 238 as "paid or accrued" or "paid or incurred", and provides that "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under § 212. Section 212 (b) requires that net taxable income shall be computed "in accordance with the

method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as, in the opinion of the Commissioner does clearly reflect the income."

Section 13 (d) of the Revenue Act of 1916, c. 463, 39 Stat. 756, in force until the Act of 1918 became effective, provided that a corporate taxpayer "keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned". Treasury Decision 2433 of January 8, 1917, interpreting this section, states: "This ruling contemplates that income and authorized deductions should be computed and accounted for on the same basis", and Income Tax Ruling, January-June, 1921, Cum. Bulletin No. 4, p. 147, provides: "Section 13 (d) of the Revenue Act of 1916 is a qualifying section and when accounts of a corporation are kept on a basis other than that of receipts and disbursements, it qualifies the manner of making deductions authorized in § 12 (a) of the Act, and the word 'paid' in the latter section is to be read 'paid or accrued', depending on how the accounts of the corporation are kept."

The Court of Claims found that the books of the petitioner were kept on the accrual basis; that while there were some exceptions of small items of deferred charges and credits and the expenses of the London office which were entered on its books only when paid or received, "the principal and dominant purpose and plan of its accounts were to show income upon an accrual basis as the general and controlling character of the account". It also found that the petitioner's return for 1918 was on the accrual basis, as were its tax returns for 1916, 1917 and 1919.

These findings are conclusive here. *Luckenbach S. S. Co.* v. *United States*, 272 U. S. 533, 538. Under them petitioner's liability for the tax collected must turn on the propriety of deducting the foreign tax payments from income for the year 1918, when paid, in order to arrive at the true income of the taxpayer. Under the

1916 Act where the taxpayer's books are kept and his returns made on the accrual basis, taxes charged on the books as they accrue must be deducted when accrued, if true income is thus reflected. *United States* v. *Anderson,* 269 U. S. 422. Even if not so charged, it was competent for the Commissioner, under the Act of 1916, as well as under the express provisions of § 212 (b) of the Act of 1918, to correct the taxpayer's return by deducting payments in the year in which they accrued so as to reflect true income by conforming to the dominating or controlling character of the taxpayer's system of accounts. *United States* v. *American Can Co.,* decided February 24, 1930. See *United States* v. *Mitchell,* 271 U. S. 9, 12-13.[1]

The findings do not disclose whether the foreign taxes paid in 1918 had accrued in that or in earlier years, or whether under the petitioner's system of bookkeeping their deduction in some earlier year was necessary in order to ascertain true income. But the presumption is that taxes paid are rightly collected upon assessments correctly made by the Commissioner, and in a suit to recover them the burden rests upon the taxpayer to prove all the facts necessary to establish the illegality of the collection. *United States* v. *Anderson, supra;* see *United States* v. *Rindskopf,* 105 U. S. 418. In the absence of findings determining the fact, it cannot be assumed in petitioner's favor that the British taxes paid in 1918 did not accrue earlier, or that their deduction if made in 1918, would reflect truly the income of the taxpayer whose books and tax return were on the accrual basis.

Petitioner argues that as its payments of foreign taxes were charged on its books in the year when paid, as were other expenses of the London branch, its return was made on the basis upon which

[1]Treasury Regulations 45 (1920 Ed.) promulgated under the Revenue Act of 1918 contained the following:

"ART. 23. *Bases of computation.*—(1) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 200 of the statute for definitions of 'paid', 'paid or accrued', and 'paid or incurred'. . . . in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. See section 213 (a) of the statute."

This regulation has been continued without material change.

its accounts were kept and that under § 212 (b) its tax should have been computed upon its income as so returned, if that method reflected true income. It is insisted that in the absence of a finding to the contrary, this must be assumed, since the Commissioner made no readjustment of petitioner's account of the London office expenses, except the item of foreign taxes, and as it affirmatively appears in the findings that returns were made and accepted on the same basis as the 1918 return, for the tax years 1919 and 1924. But this argument likewise rests upon the assumption of facts which are without support in the findings; that the other expenses of the London office for 1918 and the foreign tax payments deducted in the 1919 and 1924 returns did not accrue in those years. If that assumption is made failure of the Commissioner to correct the returns in these respects is as attributable to his error or oversight or lack of information as to any opinion on his part as to the propriety of the deductions in the years made.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.